UNITED STATES
POSTAL REGULATORY COMMISSION
Washington, D.C. 20268-0001

FORM 10-K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended SEPTEMBER 30, 2011

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________ to ____________

Commission file number N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

Washington, D.C.	**41-0760000**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

475 L'Enfant Plaza, S.W.
Washington, DC 20260
(202) 268-2000
(Address and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
N/A	N/A

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes ☑ No ☐

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

The aggregate market value of shares of common stock held by non-affiliates at September 30, 2011, was N/A
Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock	Outstanding Shares at November 15, 2011
No Common Stock	N/A

DOCUMENTS INCORPORATED BY REFERENCE None

United States Postal Service

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Part I

ITEM 1 — BUSINESS

OVERVIEW

In accordance with the provisions of the *Postal Reorganization Act*, the United States Postal Service (we or the Postal Service) began operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States" with the mandate to offer a "fundamental service" to the American people, "at fair and reasonable rates." We fulfill this legal mandate to provide universal service at a fair price by offering a variety of postal services to our many customers. Within each class of Mailing Services, prices do not vary unreasonably by customer for the service provided. The Postal Service is governed by an eleven-member Board of Governors (the Board), of which nine members are independent Governors appointed by the President of the United States with the advice and consent of the Senate, plus the Postmaster General, who is appointed by the independent members of the Board of Governors, and the Deputy Postmaster General, who is appointed by the independent Governors and the Postmaster General.

The *Postal Accountability and Enhancement Act, Public Law 109-435* (P.L. 109-435), made further revisions to the *Postal Reorganization Act*. The Postal Service's governing statute is codified in Title 39 of the United States Code. P.L. 109-435 also created the Postal Regulatory Commission (PRC), endowing the PRC with regulatory and oversight obligations.

We serve individual and commercial customers throughout the nation, competing for business in the communications, distribution, delivery, advertising and retail markets.

The law divides our services into two broad categories: market-dominant and competitive. Throughout this document and in the day-to-day operation of the organization, market-dominant services are referred to as "Mailing Services" and competitive services as "Shipping Services." Mailing Services include First-Class Mail, Standard Mail, Periodicals, and Package Services. Price increases for these services are generally subject to a price cap based on the Consumer Price Index — All Urban Consumers (CPI-U).

Shipping Services include, but are not limited to, Priority Mail, Express Mail, Bulk Parcel Post, and Bulk International Mail. The regulations for Shipping Services place no upper limit on price changes but do set a price floor.

Mailing and Shipping Services are sold through a network consisting of over 32,000 Post Offices, stations, and branches, plus thousands of contract postal units, community Post Offices, Village Post Offices, a network of retail establishments that sell postage stamps and other services as a convenience to our customers, and our website, http://www.usps.com. Mail is delivered to more than 151 million city, rural, Post Office box and highway delivery points.

One of the principal requirements introduced by P.L. 109-435 is the requirement that, over time, our obligations for the established health and retirement benefits of current retirees and current postal employees who have not yet retired be fully funded. To accomplish this, the law established a Postal Service Retiree Health Benefits Fund (PSRHBF) and requires that we make annual prefunding payments of between $5.6 billion and $11.1 billion into the PSRHBF between 2012 and 2016. These amounts are in addition to the $38 billion contributed from 2007 through 2010. There were no contributions in 2011.

All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters.

Additional disclosures on the organization and its finances, including Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, financial and strategic plans and the *Comprehensive Statement on Postal Operations* may be found at http://about.usps.com. Information on this website is not incorporated by reference into this document.

STRATEGY

The mission of the Postal Service is to provide secure, reliable, and affordable universal delivery service. The postal business model for delivering trusted, affordable service to the nation worked well until recent years when customer preferences have rapidly evolved and new technology has changed how Americans transact business and communicate. First-Class Mail volume, instead of increasing, is now declining, even as the cost of delivering mail to an expanding number of addresses continues to grow. Additionally, P.L. 109-435 imposed a unique requirement to prefund retiree health benefits, something which is not required for other government organizations or private entities, and which is not supportable by current operations. These challenges now threaten the financial viability of the Postal Service.

To address the new challenges, the Postal Service is taking a two-pronged approach: first, aggressively pursue actions it can take within existing law to address changes in the marketplace; second, request changes to the legislative and regulatory framework surrounding the Postal Service that will restore its financial viability.

ACTIONS WITHIN MANAGEMENT CONTROL

Early in 2011 the Postmaster General outlined four key strategies for the organization:

- Become a leaner, smarter, faster organization.
- Strengthen the business-to-customer channel.
- Improve the customer experience.
- Compete for the package business.

The organization responded with initiatives to strengthen the Postal Service position, examples of which follow:

Become a leaner, smarter, faster organization

- Redesign the operating network, infrastructure, and processes by reviewing retail office productivity and studying under-utilized offices for potential consolidation, closure, or conversion to a contract unit, as well as pursuing the reduction in the number of mail processing facilities.
- Implement tools such as the Lean Six Sigma process and train employees who work in teams to find ways to reduce waste, strengthen business processes, improve service, and provide a better customer experience.
- Continue to reduce labor costs through reductions in employee costs.
- Continue leadership in the public and private sector to achieve reductions in energy costs, implement sustainable business practices, and maintain a safe working environment.

Strengthen the business-to-customer channel

- Introduce new platforms and complete the implementation of existing platforms to make it easier for small businesses to develop direct mail campaigns.
- Create and implement Every Door Direct Mail (EDDM), which enables local businesses to target potential customers by carrier route.
- Launch phase two of the redesign of the postal website, *http://www.usps.com*, in 2012, with new features and tools to make it easier to get information on Mailing and Shipping Services relevant to the business mailer.

Improve the customer experience

- Continue to operate an extensive customer experience measurement program that provides details on specific problems and useful information to help identify actions to improve service.
- Offer customers convenience by increasing access to our products and services through the introduction of Village Post Offices and by increasing the number of partnerships with third-party retailers, thereby reducing customer dependence on traditional Post Offices.
- Maintain our position as a secure and well-respected service provider, which, in a digital world where privacy and security are sometimes threatened, is becoming more important.

Compete for the package business

- Improve the reliability of package tracking by increasing the scan rate.
- Offer simple solutions such as Flat Rate package options and new solutions to make it easier for consumers and small businesses to use Postal shipping services.
- Continue to offer competitive pricing for deliveries of small packages within short-range destination zones.

ACTIONS DEPENDENT ON LEGISLATIVE AND REGULATORY CHANGES

The business environment has changed so dramatically in recent years that incremental change following traditional paths is not enough. Therefore, in addition to the actions stated above and expanding upon the March 2010 plan, *Ensuring a Viable Postal Service for America: An Action Plan for the Future*, the Postal Service has requested that Congress enact legislation focusing on the following areas:

- Resolve the prefunding of retiree health benefits and the overfunding of the Civil Service Retirement System (CSRS).
- Return the overfunding of the Postal Service's obligation to the Federal Employees Retirement System (FERS). According to the Office of Personnel Management's (OPM) latest calculation, the amount of overfunding has grown from \$6.9 billion as of September 30, 2009, to \$10.9 billion as of September 30, 2010, the latest actual data available. The surplus is projected to grow to \$11.4 billion by September 30, 2011, assuming all FERS employer contributions are made.
- Allow the Postal Service to determine delivery frequency.
- Develop a more streamlined governance model for the Postal Service that would allow for quicker pricing and product decisions than exist within the current regulatory framework.
- Allow the Postal Service the flexibility to restructure its healthcare system.
- Permit the streamlining of pricing and product development.
- Direct arbitrators to take into consideration the financial situation of the Postal Service when making decisions on collective bargaining agreements.

To effectively and quickly implement change requires continuing, unprecedented innovation and collaboration from all stakeholders. To ensure that both ongoing and new key initiatives are integrated and effectively implemented, in 2011 the Postal Service developed a rigorous process for testing the viability of and tracking high-priority change initiatives. An updated Strategic Plan, covering the period FY 2012 - 2016, is currently being developed. The Postal Service's Executive Leadership are engaged and committed to supporting the initiatives that show promise for the future.

SEGMENTS

Although the law divides our services into market-dominant and competitive categories, and revenue is monitored by category and class, we operate one fully integrated network, which is one segment throughout the United States, its possessions and territories. Revenue from international operations represents less than 4% of total revenue.

SERVICES

The Postal Service is the centerpiece of the U.S. mailing industry, providing a wide variety of services to meet almost any mailing need. Services include Mailing Services and Shipping Services as described in more detail below.

MAILING SERVICES

First-Class Mail — Offered for postcards and letters, or any flat advertisement or merchandise up to 13 ounces destined for either domestic or international delivery. Personal correspondence, handwritten or typewritten letters, bills or statements of account, and payments must be mailed via First-Class Mail, Express Mail, or Priority Mail.

Standard Mail — Offered for any item, including advertisements and merchandise weighing less than 16 ounces, that is not required to be sent using First-Class Mail. Standard Mail is typically used for direct advertising to multiple delivery addresses. Content restrictions apply for authorized nonprofit mailers.

Periodicals — Offered for newspaper, magazine and newsletter distribution. This service requires prior authorization by the Postal Service.

Package Services — Offered for any merchandise or printed matter weighing up to 70 pounds. These services include single-piece Parcel Post, Bound Printed Matter, Library Mail, and Media Mail.

Extra Services — Offered for a variety of enhancements that add value to Shipping and Mailing Services. Many provide added security, proof of delivery, or loss recovery. Examples of these services include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation, Adult Signature and Insurance up to $5,000 available online, at Post Offices or at Automated Postal Centers.

Post Office Boxes — Provide customers an additional method for mail delivery that is private and convenient.

Money Orders — A special service offering a safe, convenient, and economical alternative to sending cash through the mail or for the payment of bills. They can be purchased at any Post Office or from any rural route carrier and can be sent within the U.S. and to some foreign countries. Postal money orders are available for any amount up to $1,000. Money orders can be cashed at any Post Office or can be deposited or negotiated at financial institutions. The Postal Service will replace money orders that have been damaged, lost, or stolen.

SHIPPING SERVICES

Express Mail — Includes domestic and international offerings. This primarily overnight, money-back guaranteed service includes tracking, proof of delivery, and basic insurance up to $100. Delivery is offered to most domestic U.S. destinations and is available 365 days a year. A surcharge is added for Sunday and holiday delivery. Express Mail Flat Rate envelopes are available for shipments to any location in the United States. Commercial Base and Commercial Plus pricing is available for customers meeting certain volume thresholds. Express Mail International offers fast delivery service to over 190 countries with guaranteed service to select destinations using Global Express Guaranteed.

Priority Mail — Offered as a service both within the U.S. and to numerous destinations abroad. The domestic offering is a 2–3 day nonguaranteed delivery service that is typically used to send documents, gifts, and merchandise. Priority Mail Flat Rate boxes and envelopes are available for shipments at fixed prices. Commercial Base and Commercial Plus pricing is available for customers meeting certain volume thresholds. Priority Mail Regional Rate Boxes offer zone pricing to reduce costs. Commercial cubic pricing is available for Priority Mail parcels. Priority Mail International provides customers with a reliable and economical means of sending items weighing up to 70 pounds to over 190 countries and territories worldwide.

Parcels — Parcel Select and Parcel Return Services provide commercial customers with an economical means of shipping packages. By taking advantage of the "first mile and last mile" strengths of the Postal Service, Parcel Select saves customers money by entering packages into the postal network closer to their ultimate destination. Parcel Select Regional Ground is a low-cost regional service for high-volume customers who ship small packages up to 5 pounds for zones 1–8. Parcel Return Service provides a service to commercial customers allowing them to easily and economically retrieve packages returned by their customers. Parcel Select and

Parcel Return Services allow us to partner with privately owned delivery services to serve our respective customers' needs.

Details on Mailing and Shipping Services revenue are found in the Operating Statistics table immediately following the Notes to the Financial Statements.

PRICING AND CLASSIFICATION ACTIVITY

Postal Service prices are set by the Board and reviewed by the PRC for legal compliance. We have provided, and anticipate continuing to provide, at least 90 days advance notice of any new prices for Mailing Services. There was a 1.7% price increase for Mailing Service products in April 2011; a January 2012 proposed average price increase of 2.1% was announced on October 18, 2011. The price of a one-ounce First-Class Mail stamp is currently $0.44; if approved by the PRC, this price will increase to $0.45 with the January 2012 increase.

Prices for Shipping Services by law must cover costs attributable to each product, as well as an appropriate share of the institutional costs of the Postal Service. The institutional cost allocation, determined by the PRC, is 5.5% of total institutional costs in addition to 100% of attributable costs. By law, changes in Shipping Services prices must be announced at least 30 days prior to the implementation date.

Prices for Shipping Services products – including Express Mail, Global Express Guaranteed, Express Mail International, Priority Mail, Priority Mail International, Parcel Select, and Parcel Return Service – increased an average of 3.6% in January 2011.

We offer contract prices, rebates, online price reductions, and other incentives to encourage growth.

INTELLECTUAL PROPERTY

We own intellectual property that includes trademarks, service marks, patents, copyrights, trade secrets, and other proprietary information, and routinely generate intellectual property in the course of developing and improving systems, services, and operations. While legal protection for intellectual property and proprietary information is significant to our success, the knowledge, ability, and experience of our employees and the timeliness and quality of service we provide are more significant.

SEASONAL OPERATIONS

Mail volume and revenue are historically greatest in the first quarter, which includes the fall holiday mailing season, and lowest during the summer, or fourth quarter, of the fiscal year.

CUSTOMERS

We have a very diverse customer base and are not dependent on a single customer or small group of customers. No single customer represents more than 1% of operating revenue, although advertising mail in general accounts for more than half of our volume.

GOVERNMENT CONTRACTS

No material portion of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. Government.

COMPETITION

A wide variety of communications media compete for the same types of transactions and communications that historically have been conducted using Mailing Services. These competitors include, but are not limited to, newspapers, telecommunications, television, e-mail, social networking, and electronic funds transfers. Shipping Services compete on the basis of the breadth of our service network, convenience, reliability, and economy of the service provided. The package and express delivery businesses are intensely competitive and are likely to remain so. The primary competitors of Shipping Services are FedEx Corporation and United Parcel Service.

RESEARCH AND DEVELOPMENT

We operate a research and development facility in Virginia for design, development, and testing of postal equipment and operating systems and also contract with independent suppliers to conduct research activities. While research and development activities are important to our business, these expenditures are not material.

ENVIRONMENTAL MATTERS

We are not aware of any federal, state, or local environmental laws or regulations that would materially affect our financial results or competitive position or result in material capital expenditures. However, the effect of possible future environmental legislation or regulations on operations cannot be predicted. Discussions regarding the effects of greenhouse gases on the environment may result in new laws or regulations that regulate greenhouse gas emissions into the environment and, as a result, our operating costs may increase. The costs that we believe may increase as a result of any new environmental laws or regulations could include: diesel fuel, unleaded gasoline, the cost of retrofitting existing vehicles, and other petroleum-related products, such as tires.

EMPLOYEES

At September 30, 2011, we had approximately 557,250 career employees and 88,700 non-career employees, substantially all of whom reside in the U.S.

The labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU), and National Rural Letter Carriers' Association (NRLCA). The current contract with the APWU became effective May 23, 2011, and extends through May 20, 2015. The NRLCA contract expired on November 20, 2010, and the NPMHU and NALC contracts expire on November 20, 2011. If agreements are not reached during negotiations, a federal mediator is appointed, unless the parties agree otherwise. Impasses in collective bargaining negotiations may ultimately be resolved through arbitration. The Postal Service has reached an impasse in negotiations with the NRLCA. The Postal Service and the NRLCA have agreed to bypass mediation and move directly to arbitration. Arbitration hearings are scheduled to begin on December 5, 2011. Contract negotiations with the NPMHU and NALC are ongoing as of the date of this report.

More than 85% of career employees are covered by collective bargaining agreements. By law, the Postal Service must consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide nonbargaining unit employees in the field with an opportunity to participate directly in the planning, development, and implementation of certain programs and policies that affect them. Management organizations include the National Association of Postal Supervisors (NAPS), the National League of Postmasters and the National Association of Postmasters of the United States (NAPUS). The Postal Service participates in federal employee benefit programs as provided by statute and contract for retirement, health, and workers' compensation benefits.

AVAILABLE INFORMATION

Financial and other information about the Postal Service is available on *http://about.usps.com/who-we-are/financials/welcome.htm*. Information on the website is not incorporated by reference in this report.

We make available on our website, free of charge, copies of our recent annual reports, quarterly reports, and current reports as soon as reasonably practicable after they are filed with or provided to the PRC. Requests for copies may also be sent to the following address:

Corporate Communications
United States Postal Service
475 L'Enfant Plaza, SW
Washington, DC 20260-3100

Part I

ITEM 1A — RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations and cash flows. Here, we provide a broad overview of the chief external factors that influence, and in some cases govern, operations and financial results, briefly discussing their specific impacts in 2011 as well as their anticipated near-term effects. The remainder of this report, notably the sections entitled “Business” and “Management's Discussion and Analysis of Financial Condition and Results of Operations,” provides a further understanding of the risks and uncertainties we confront.

Adverse changes in the economy directly impact our business, negatively affecting results of operations.

The global economy may impact our business and financial condition in ways that we currently cannot predict. The demand for postal services is heavily influenced by the economy. Throughout 2011, the U.S. national unemployment rate has remained high, improving only slightly, to 9.1% in September 2011 from 9.6% in September 2010. The high unemployment rate, along with continued weakness in housing prices and lackluster economic growth, continue to adversely impact consumer confidence, raising economic risk significantly. These uncertain economic conditions are expected to have a continuing adverse impact on retail sales, investment, consumer spending, consumer confidence, and ultimately the use of the mail. Negative trends in these areas continue to depress the demand for postal services. In addition, to the extent that the recovery from the recent recession in the U.S. and in other countries takes longer than anticipated, our business, financial position and results of operations continue to be adversely impacted.

Even with some regulatory and legislative changes, our ability to generate sufficient cash flows from current and future management actions to increase efficiency, reduce costs, and generate revenue may not be sufficient to meet all our financial obligations.

The Postal Service continues to suffer from a severe lack of liquidity caused by over $25 billion of net losses over the past five years including $21 billion of expenses for the prefunding of retiree health benefits. The Postal Service ended 2011 with $1.5 billion of total cash and $2.0 billion of remaining borrowing capacity on its $15 billion debt facility. The Postal Service’s current financial projections indicate that it will not be able to make the required $5.5 billion prefunding payment for retiree health benefits currently due by November 18, 2011, or the required $5.6 billion prefunding payment for retiree health benefits that is due by September 30, 2012.

In addition to the numerous cost reduction steps already taken, on June 24, 2011, the Postal Service suspended its employer’s contributions to the federal Office of Personnel Management (OPM) for the defined benefit portion of its Federal Employees Retirement System (FERS) funding requirement. This action was necessary in order to help provide sufficient liquidity to fund Postal Service operations in light of continued weakness in mail volumes and the significant uncertainty regarding possible legislative reforms. Additionally, based on the Civil Service Retirement and Disability Fund (CSRDF) Board of Actuaries Long Term Funding Assumptions, the Postal Service had overfunded its FERS obligations by $6.9 billion at September 30, 2009, and sought to apply that overfunded balance to amounts currently due for employer contributions. OPM’s latest calculation shows that the surplus has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and it is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer’s contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011. However, we continue to seek a refund of the overfunded balance.

It is currently projected that the Postal Service’s efforts to positively impact cash flow will not be sufficient, either individually or in the aggregate, to avoid a cash shortfall. Absent significant changes in the law, it is very likely that the Postal Service will default on the $5.5 billion prefunding payment to the PSRHBF due by November 18, 2011, and on the $5.6 billion prefunding payment due by September 30, 2012. Additionally, even if legislative changes defer or eliminate the $11.1 billion of PSRHBF prefunding payments currently due in 2012, the $15 billion debt ceiling will likely be reached in October 2012 when we are required to make a payment of approximately $1.3 billion to the DOL for workers’ compensation, because the Postal Service is expecting to resume payments to FERS, thereby exhausting the Postal Service’s external funding ability.

The legal and/or regulatory consequences of a default on the required PSRHBF contributions or the workers’ compensation payments to the U.S. Government are unknown.

Our strategies to increase efficiency and reduce costs by adjusting our network, infrastructure, and workforce, and to retain and grow revenue are currently constrained by contractual, statutory, regulatory, and political restrictions. The ability to generate sufficient cash flow to meet obligations is also substantially dependent on the continuance, strength, and speed of the economic recovery and the execution of operational strategies available under current law to increase efficiency and generate incremental revenue.

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF prefunding payment schedule and FERS overfunding, the Postal Service will continue to face financial stability concerns. While management continues to take action to improve the Postal Service's overall financial situation, the outlook continues to show the financial necessity for additional changes. There is an urgent need for additional legislative changes on multiple issues, including finding a long-term solution to the current PSRHBF prefunding schedule, refunding the FERS surplus, permitting a change in delivery frequency, allowing a restructuring of existing healthcare benefits programs, and the development of a more streamlined governance model for both products and pricing.

Even if these regulatory and legislative changes are enacted, there is no assurance that those changes will occur in time to favorably impact 2012, or at all.

We will continue to inform Congress and other stakeholders of our financial condition and outlook and pursue legislative changes, cost reductions, and additional ways to generate revenues that would help ensure the availability of adequate cash at the end of 2012. Although the Postal Service's cost-reduction and revenue-generation initiatives are expected to positively impact cash flow, we project that they will not, in the aggregate, be sufficient to offset the expected November 18, 2011, or September 30, 2012, cash shortfalls. Many of the structural reforms needed to ensure long-term viability, such as adjustments to the PSRHBF prefunding payment schedule, can only be achieved with legislative change. There can be no assurance that Congress will enact additional legislation that impacts 2012 or future years.

We are subject to Congressional oversight and regulation by the Postal Regulatory Commission and other government agencies. We have a wide variety of stakeholders whose interests and needs are sometimes in conflict.

This is an outgrowth of our unique status as a provider of a fundamental service to the American people. We attempt to balance the interests of all parties. Efforts to be responsive to various stakeholders sometimes adversely impact the speed with which we are able to respond to changes in mail volume or other operational needs. Any limitations on our ability to take management action could adversely affect operating and financial results.

Adverse events may call into question our reputation for quality, reliability or our ability to deliver the mail, and could diminish the value of the Postal Service brand. This could potentially adversely affect our revenues and results of operations.

We serve almost every American household and business six days a week. As of their latest survey, and for six consecutive surveys, the Ponemon Institute named the Postal Service the most trusted government agency. This clearly demonstrates that Americans continue to trust and depend on us. The Postal Service brand represents quality and reliable service and therefore is a valuable government asset. We use our brand extensively in sales and marketing initiatives and take care to defend and protect it.

Recent events regarding our financial condition and our plans to study certain postal facilities for potential closure have been highly publicized. Both Congress and the Administration have offered various proposals to solve some of the complex issues affecting the Postal Service. Although the approaches of various legislators and the Administration often differ, and there is a lack of consensus in many areas, the intent of all stakeholders is the same – to preserve the Postal Service and improve its overall financial health. Reports in the press regarding these discussions may result in confusion or misunderstanding by our customers regarding the future viability of the Postal Service. As a result, there is a possibility that customers may change their buying habits based upon these misperceptions.

Any event, whether real or perceived, that calls into question our ability to deliver mail, our quality, or our reliability could diminish the value of our brand and reputation and could adversely affect our business operations and operating results.

Our need to restructure our operations in response to declining mail volumes may result in significant costs. It is possible that the measures being considered may be insufficient to reduce our workforce and physical infrastructure to a level commensurate with lower and declining mail volumes.

Our current restructuring plans include studies to evaluate the potential closure or consolidation of mail processing operations, retail units, Post Offices, and other facilities and significantly decrease the number of employees. At the current time, our regular review of the carrying value of our assets has not resulted in significant impairments of our physical assets. However, future changes in business strategy, legislation, government regulations, or economic or market conditions may result in material impairment write-downs of our assets. In addition, we may in the future consider offering financial incentives to encourage employees to voluntarily leave the Postal Service, as has been done in the past. Such impairments or other restructuring costs would adversely impact our financial results in the short term, although they would result in long-term savings. In addition, there is no assurance that the mechanisms available under existing law and contractual arrangements will be sufficient to reduce the workforce or facilities to a level that would allow a return to profitability.

Our business and results of operations are adversely affected by electronic diversion. If we do not compete effectively with electronic communications services, or grow marketing mail, package services, or revenue and profit margins from other sources, this adverse impact will become more substantial over time.

Customer usage of postal services continues to shift away from transactions, correspondence, and Periodicals Mail toward advertising and Shipping Services. Advertising and Shipping Services are highly correlated with economic activity. Over the past 5 years, transactional mail, such as the presentment and payment of bills, has been sharply eroded by competition from electronic media, driven by some of our major mailers who actively promote such use of online services. Factors underlying this trend include growing internet access in homes, increased availability of broadband service, low personal computer prices, expansion of mobile internet access, increasing familiarity and comfort with the internet, and the growing trend by businesses to incent or require their customers to use alternatives to mail for payments and statement presentment.

Correspondence mail has long been a declining part of mail volume. With the availability of inexpensive telephone service, e-mail, and other internet-based forms of communication such as e-cards and social networking, there is little chance that the decline in correspondence mail will be reversed.

Periodicals in the mail continue to decline as people increasingly use electronic media for news and information. The impact of the recession and electronic competition has amplified the steep decline in periodicals advertising.

Existing laws and regulations limit our ability to introduce new services or products, enter new markets, or generate new revenue streams, and thus grow and evolve as an important American institution.

In order to offset declining volumes and revenues caused by electronic diversion, our ability to sell new products and services in new or existing markets will be a key factor to our return to profitability. However, various laws and regulations seriously limit our ability to enter new markets and/or to provide new services and products as defined by traditional industry definitions. Without legal or regulatory changes that would allow us to introduce new products or services to take advantage of our assets, including our strong network and last-mile capabilities, we may be unable to respond to consumers' changing needs and expectations. This would adversely impact our results of operations and long-term financial viability.

An unaffordable union contract arrived at either through negotiation or arbitration could have a significant impact on our future results of operations.

The majority of our labor force is represented by labor unions and covered by collective bargaining agreements, primarily with the APWU, NALC, NPMHU and the NRLCA. The agreements currently in force include provisions for mandatory cost-of-living adjustments (COLA). They also contain provisions that limit our ability to reduce the size of the labor force. Reductions in the size and cost of our labor force are necessary to offset the effects of declining volumes and revenues.

The current APWU contract, ratified in May 2011, expires in May 2015. Contract negotiations with the NPMHU and NALC began in August 2011 as their contracts expire on November 20, 2011. Negotiations continue as of the date of this report. The contract with the NRLCA expired on November 20, 2010. After an impasse was reached in the NRLCA negotiations, the parties bypassed mediation and proceeded directly to arbitration. Arbitration hearings are scheduled to begin on December 5, 2011.

We have no assurance that we will be able to negotiate contracts with our unions that will result in a cost structure that is sustainable within current and projected future mail revenue levels. In addition, there is no current statutory mandate requiring an interest arbitrator to consider the financial health of the Postal Service in issuing an award. An unaffordable decision received in arbitration could have significant adverse consequences on our ability to meet future financial obligations.

While the Postal Act of 2006 (P.L. 109-435) limited price increases on our Mailing Services to the rate of inflation, our costs are not similarly limited. Accordingly, we may not be able to increase prices sufficiently to offset increased costs. This would adversely affect our results of operations.

Postal costs are heavily concentrated in wages, employee and retiree benefits, and transportation. These costs are significantly impacted by wage inflation, health benefit premium increases, retirement and workers' compensation programs, cost-of-living allowances, fuel prices, and the continuous expansion of our delivery network. We believe that continuing productivity improvements, by themselves, will not be sufficient to address the challenge presented by declining volumes and revenues and the regulatory price cap.

The contracts with the four unions representing the majority of our employees have historically included provisions granting COLAs, which are linked to the

Consumer Price Index — Urban Wage Earners and Clerical Workers (CPI-W). The most recent COLA, effective in September 2011, conferred an annual pay increase of nearly $980 on each eligible employee covered by NPMHU and NALC collective bargaining agreements. As a result of the new contract with the APWU, their members did not receive a COLA in 2011. Future APWU COLAs are deferred until 2013. In addition, NRLCA members received no COLA in 2011 because their contract expired in November 2010 and is currently in arbitration.

Although the CPI-W has been relatively low since its 2008 peak when it conferred annual pay increases to employees of nearly $1.1 billion, a resurgence of consumer inflation could have a significant adverse impact on our labor costs. The ability to negotiate contracts that control labor costs is essential to maintaining financial stability. Failure to do so, or an unfavorable decision by an arbitrator should we be unable to agree to terms with the unions, could have significant adverse consequences on our ability to meet financial obligations.

The determination of the workers' compensation liability is highly influenced by interest rates, the CPI-W, and medical inflation. Changes in CPI and medical inflation increase the liability while interest rates have an inverse relationship. An increase of 1% in the interest rate would decrease our estimate of the liability by approximately $1.5 billion. A decrease of 1% in the interest rate would increase our estimate of the liability by approximately $1.9 billion. While these interest rate assumptions do not affect our annual cash payment to the Department of Labor (DOL), the CPI-W and medical cost increases do affect the payments made to claimants.

Fuel expenses are a material part of operating costs. A significant increase in fuel prices could adversely affect costs and results of operations.

We are exposed to changes in commodity prices primarily for diesel fuel, unleaded gasoline and aircraft fuel for transportation of mail, and natural gas and heating oil for facilities. A 1% increase in fuel costs would result in a $26 million increase in expense. We did not use derivative commodity instruments to mitigate the financial risk of changes in energy prices during the periods covered by this report.

We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results and manage our business. Disruptions in both our primary and secondary (back-up) systems could harm our ability to run our business and potentially result in significant losses of revenue or additional operating costs. In addition, such disruptions could impair our reputation for reliable service, which would also adversely affect results of operations.

We rely extensively on technology to manage and operate systems for payment, processing, and delivery of mail. Our operational and administrative information systems are among the largest and most complex systems maintained by any organization in the world. We have a number of systems that are nearing the end of their useful lives. Replacing these systems will require substantial investments. Any significant systems failure could cause delays in the processing and delivering of mail or result in the inability to process operational and financial data. System failures such as this could damage our reputation, resulting in loss of business and increased costs.

Due to our current cash constraints, our operational performance in the future could be at risk as a result of inadequate capital investment in transportation equipment, mail processing equipment, facilities, or information technology which are either essential to operations or to improve the quality of our services.

Failure to anticipate or react to our competition, market demands, and/or new technology due to inadequate cash reserves is a significant operational risk. Aging facilities and failing transportation equipment could inhibit our ability to be competitive in the marketplace, deliver a high-quality service, and meet the communication needs of the American public. The changes in the economic landscape in recent years have made it increasingly important for the Postal Service to invest in its operations in order to remain competitive. If our operations do not generate the liquidity we require, we may be forced to reduce, delay, or cancel investments in technology, facilities, and/or transportation equipment while our direct competitors and other businesses are pursuing advanced, competing technologies and equipment. Aging or potentially obsolete infrastructure could result in a loss of business and increased costs.

The potential liability associated with existing and future litigation against us could have a material adverse effect on our business, results of operations, financial condition, and cash flows.

We are subject to various legal proceedings and threatened legal proceedings from time to time. Any litigation, regardless of its merits, could result in substantial legal fees being incurred by us. Further, actions that have been or will be brought against us may not be resolved in our favor and, if significant monetary judgments are rendered, we may not have the ability to pay. Such disruptions, legal fees, and any losses resulting from these claims could have a material adverse effect on our business, results of operations, financial condition, and cash flows.

A failure to protect the privacy of information we obtain from customers could damage our reputation and result in a loss of business.

We receive a variety of private information from customers, such as address-change data. We have implemented a number of state-of-the-art safeguards intended to protect the confidentiality of data that we obtain. Should these safeguards be breached, however, our reputation could be damaged with a resultant loss of business.

International conflicts or terrorist activities and the effects of these events may have adverse impacts on business operations or our financial results. In addition, we are subject to the risk of biohazards and other threats placed in the mail.

We are exposed to the impacts of terrorist activities and conflicts on the United States, global economies in general, and the transportation industry in particular. In addition, we are particularly subject to the risk of biohazards and other threats placed in the mail. Although we have implemented extensive emergency preparedness measures to keep the mail, employees and customers safe from harm due to biohazards or other threats that could be introduced into the mail, this risk cannot be completely mitigated. If new threats were to arise and measures were not sufficient to contain or mitigate the threat, services could be disrupted. This could adversely affect mail volumes and revenue, and require substantial expenditures to address the new threat, thus adversely affecting our operations and financial condition.

We may be adversely impacted by the legal or regulatory responses to actual or perceived global climate change.

Concerns about climate change, particularly global warming, have resulted in significant discussions in the scientific community, domestic and international governments, and environmental organizations about the effects of greenhouse gases on the environment. These discussions may result in new laws or regulations that regulate greenhouse gas emissions into the environment and, as a result, our operating costs may increase. The costs that we believe may increase as a result of any new environmental laws or regulations could include: diesel fuel, unleaded gasoline, the cost of retrofitting existing vehicles, and other petroleum-related products, such as tires. In addition, utility costs associated with the operation of facilities may increase as a result of new environmental laws and regulations. Finally, since we also use contracted carriers to transport the mail, we anticipate that increased operating costs for these independent carriers, including increased costs resulting from new laws or regulations, may ultimately be passed through to the Postal Service.

We are also subject to risks and uncertainties that affect many other businesses, including:

- Market acceptance of new product and service initiatives;
- Adverse weather conditions or natural disasters, such as hurricanes, which can damage property and disrupt operations;
- Widespread outbreak of an illness or any other communicable disease, or any other public health crisis; and
- Changes in interest rates and foreign currency exchange rates.

ITEM 1B – UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2 — PROPERTIES

REAL ESTATE

Facilities range in size from 55 square feet to 32 acres under one roof and support retail, delivery, mail processing, maintenance, administrative, and support activities.

Real Estate Inventory (Actual numbers)	2011	2010
Leased Facilities	24,309	24,671
Owned Facilities	8,644	8,621
GSA / Other Government Facilities	307	328
Total Real Estate Inventory	**33,260**	**33,620**
Annual Rent Paid to Landlords (Dollars in millions)	**$ 998**	**$ 1,008**

USAGE OF FACILITIES

Facilities that support postal retail and delivery operations are located in virtually every community throughout the country. In addition to the 32,146 retail and delivery facilities that we operate, postal retail services are available in thousands of commercial locations owned and operated by private businesses. These include more than 3,000 Contract Postal Units, Community Post Offices, and Village Post Offices, plus over 63,000 supermarkets, pharmacies, and other stores that sell postage stamps as a convenience to our customers.

Postal-Managed Retail and Delivery Facilities (Actual numbers)	2011	2010
Post Offices	26,927	27,077
Classified Stations	3,154	3,313
Classified Branches	1,428	1,481
Carrier Annexes	637	657
Total Postal-Managed Retail and Delivery Facilities	**32,146**	**32,528**

Processing Facilities (Actual numbers)	2011	2010
Processing and Distribution Centers	251	260
Customer Service Facilities	115	164
Network Distribution Centers	21	21
Logistics and Distribution Centers	10	13
Annexes	46	51
Surface Transfer Centers	10	11
Airmail Processing Centers	1	1
Remote Encoding Centers	2	2
International Service Centers	5	5
Total Processing Facilities	**461**	**528**

Our larger facilities primarily support mail processing operations. They process millions of pieces of mail on a daily basis and prepare it for dispatch and transportation. They may also house some of the retail and delivery operations identified under retail and delivery functions.

As part of the ongoing efforts to improve efficiency, adjust the network to lower volumes of mail, and reduce excess capacity, consolidation of operations has led to a reduction in the number of facilities that support mail processing. We are currently pursuing further consolidation of mail processing facilities. Consolidations allow for reductions in headcounts and transportation costs due to efficiencies of scale in mail processing and transportation but do not always result in a reduction in real estate. Consolidation also results in more efficient use of our mail processing facilities and equipment as well as our transportation network.

VEHICLES

The Postal Service operates one of the largest vehicle fleets in the United States, including an extensive fleet of alternative-fuel vehicles. As part of the American Recovery and Reinvestment Act of 2009 (ARRA), we received approximately 6,500 new fuel-efficient vehicles between June 2009 and March 2010 from the General Services Administration in a one-for-one exchange for older postal vehicles.

Vehicle Inventory (Actual numbers)	2011	2010
Delivery and Collection (1/2 - 2 1/2 ton)	192,088	193,394
Mail Transport (Tractors & Trailers)	6,083	6,268
Administrative	6,478	6,502
Service (Maintenance)	4,625	4,702
Inspection and Law Enforcement	2,453	2,581
Mail Transport (3 - 9 ton)	2,154	2,178
Total Vehicles	**213,881**	**215,625**

ITEM 3 — LEGAL PROCEEDINGS

We are subject to various claims and liabilities that arise in the normal course of operations. These claims generally relate to labor, tort, and contract disputes and are regularly reviewed by management, and, where significant, by the Audit and Finance Committee of the Board of Governors and/or the full Board of Governors.

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Potter (first instituted in 2006), with the class consisting of all permanent rehabilitation employees and limited-duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to the present. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet-unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter.

For further discussion of the legal proceedings affecting us, please see the information under the sub-caption “Legal Matters and Contingent Liabilities” of the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this report.

ITEM 4 — (REMOVED AND RESERVED)

Part II

ITEM 5 — MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the Government of the United States," we do not issue stock or other securities.

ITEM 6 — SELECTED FINANCIAL DATA

See the Financial History Summary following the *Notes to the Financial Statements*.

ITEM 7 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENTS

Forward-looking statements contained in this report represent our best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements are included in this report and use such words as "may," "will," "could," "expect," "believe," "plan," or other similar terminology. These statements reflect current expectations regarding future events and operating performance as of the date of this report. These forward-looking statements involve a number of risks and uncertainties.

The following are some of the factors that could cause actual results to differ materially from those expressed in, or underlying, forward-looking statements: effectiveness of operating initiatives; rate of electronic diversion; changes in laws and regulations; costs and delays associated with new regulations imposed by the Postal Regulatory Commission (PRC) or other regulatory bodies; the amount of required prefunding payments to the Postal Service Retirement Health Benefits Fund (PSRHBF); success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel, and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; labor relations; effects of legal claims; cost and deployment of capital; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements. Management discusses the development and selection of these accounting policies and estimates with the Audit and Finance Committee of the Board. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three accounting policies that are considered either the most judgmental, or involve the selection or application of alternative accounting policies, and are material to financial statements, are those related to the recording of workers' compensation costs, deferred revenue for prepaid postage, and contingent liabilities.

Workers' compensation costs are highly sensitive to discount and inflation rates and the length of time recipients stay on the compensation rolls. However, the total annual cash payment for claims is relatively stable and predictable. The workers' compensation costs reflected on our Statement of Operations are subject to actuarial estimates of future pay-outs, based upon prior claims data. Changes in the actuarial and inflation rate estimates and discount rates can significantly impact reported results from period to period. In the third quarter of 2009, we instituted a policy of updating inflation and discount rates on a quarterly basis.

The discount rate reflects the current rate at which the workers' compensation liabilities could be effectively settled at the measurement date (e.g., the end of the accounting period). In setting the discount rates, we use the current yield, as of the measurement date, on a basket of Treasury securities that is matched to the expected duration of both the medical and compensation claims.

Expected inflation in compensation claim obligations is estimated using the CPI-U as forecasted by IHS Global Insight in their quarterly report. For medical claims, we use the average rate of medical cost increases experienced by our workers' compensation claimants over the past five years as an estimate for future medical inflation. This was a change beginning in 2010. Previously, we had used forecasted medical inflation rates published by an independent source. During 2010, we determined that our own history served as a better indicator of future costs and revised the estimation accordingly.

Deferred revenue-prepaid postage is an estimate of postage that has been sold but not yet used by customers. Revenue is recognized only when services are rendered. Because payments for postage are collected in advance of services being performed, revenue is deferred and reflected in the Balance Sheets as *"Deferred Revenue-Prepaid Postage."* Two categories of postage sales account for the majority of deferred revenue–prepaid postage: stamp sales and metered postage.

Stamp sales in 2011 totaled $8.3 billion. Deferred revenue on stamp sales is estimated using statistical samples of stamped mail exiting our system across the country. The estimated stamp usage is subtracted from stamp sales with the difference representing our obligation to perform future services. We reduce that obligation by recognizing a provision for stamps sold that may never be used; either through loss, damage, or collecting activity, commonly referred to as the "breakage factor."

Metered postage is primarily used by businesses. Accordingly, the deferred revenue for meters is much smaller as a percentage of annual sales than for stamps, because business customers generally manage their cash flow much more closely and purchase postage only as needed. Deferred revenue related to meters is estimated by monitoring the actual usage of all postage meters that had postage added during the month preceding the financial measurement date. The information from the two most recent meter readings allows us to derive a deferral percentage, which is applied to all postage meter receipts for the month. Metered postage receipts in 2011 subject to deferral totaled $15.7 billion.

We also include in our estimate of deferred revenue–prepaid postage an estimate for mail that is in-transit within the postal system. We do this because the earnings process is not considered complete until mail is delivered to the customer.

The chart below details our deferred revenue-prepaid postage by service category.

Deferred Revenue-Prepaid Postage

(Dollars in millions)	2011	2010
Forever Stamps	2,527	1,323
Non-Forever Stamps	246	488
Meters	459	506
Mail-In-Transit	247	254
Other, primarily precancelled stamps	18	13
Total Deferred Revenue-Prepaid Postage	**3,497**	**2,584**

Contingent liabilities require significant judgment in estimating potential losses for legal and other claims. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. In addition, each quarter any prior claims and litigation are reviewed and, when necessary, the liability balance adjusted for resolutions or revisions to prior estimates. Estimates of loss can therefore change as individual claims develop and additional information becomes available.

Other critical estimates include retirement and health benefit costs for current retirees and current postal employees who have not yet retired as they represent a significant portion of expenses. Any change in laws or regulations affecting the amounts, timing, or administration of these benefits could have a material effect on our financial position and results of operations. We participate in the federal government pension and retiree health benefits programs, and accordingly account for these using multiemployer plans accounting rules. As such the expense is the amount we are required to fund.

In addition, the depreciation and amortization of capital assets over their estimated useful lives, and the determination of salvage value, require us to make judgments about future events. Because capital assets are utilized over relatively long periods of time, we make periodic evaluations as to whether the estimated service lives or salvage values remain appropriate. Changes to estimated lives and residual values may affect the amount of depreciation expense recognized in a period and, ultimately, the gain or loss on disposal of the asset.

For further information, see Note 3, *Summary of Significant Accounting Policies,* Note 6, *Contingent Liabilities,* and Note 9, *Workers' Compensation,* in the Notes to the Financial Statements.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-09, Compensation-Retirement Benefits-Multiemployer Plans (Accounting Standards Codification 715-80) which outlines new required disclosures about an organization's involvement in those plans. The amendments are effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. Retrospective application of the new disclosures will also be required. We will be adopting the new rules for the year ended September 30, 2012.

Other new pronouncements issued but not effective until after September 30, 2011, are not expected to have a significant effect on our financial position or results of operations.

RESULTS OF OPERATIONS

Although significant efforts continue to be made to contain controllable costs, the Postal Service has not been able to completely offset the declining revenue and non-controllable cost increases of the past few years. In addition, the impact of the legally mandated Postal Service prefunding payments to the PSRHBF, significant workers' compensation expenses, increasing fuel costs, and the legally required continuation of six-day-per-week delivery in spite of declining mail volume have greatly affected our ability to return to profitability.

As explained more fully in the "Revenue and Volume" section of this report, the recession of 2007–2009 and the lingering economic weakness, along with the continuing migration of mail to electronic media have had a significant adverse impact on our operating revenue. While the recession is officially over, the economic recovery has not been as robust as other post-recession periods. Future economic growth is not expected to be sufficient to make up for the substantial losses we suffered as a result of the recession.

Since peaking at 213 billion pieces in 2006, our volume has declined each year. This trend, primarily caused by the use of electronic media to replace hard-copy transactions and communications, exacerbated by continuing economic weakness, continued through 2011 and is expected to continue for the foreseeable future.

Net losses were $5,067 million, $8,505 million, and $3,794 million for the years ended 2011, 2010, and 2009, respectively.

On September 30, 2011, P.L. 112-33, the *Continuing Appropriations Act, 2012,* became law and deferred the PSRHBF prefunding payment of $5.5 billion, previously scheduled to be due by September 30, 2011, to be due by October 4, 2011. P.L. 112-36, the *Continuing Appropriations Act, 2012,* further extended that deferral to not later than November 18, 2011. Had these two laws not been enacted, the net loss for 2011 would have been $10,567 million and the Postal Service would have been forced to default on the $5.5 billion payment that would have been due by September 30, 2011.

Operating Statistics (Dollars & pieces in millions)		2011		2010		2009
Operating Revenue	$	65,711	$	67,052	$	68,090
Prefunding Payment to PSRHBF	$	-	$	5,500	$	1,400
Loss from Operations	$	(4,923)	$	(8,374)	$	(3,740)
Net Loss	$	(5,067)	$	(8,505)	$	(3,794)
Average Daily Volume		554		563		584

The losses for the years ended September 30, 2011, 2010, and 2009 include expenses due to discount rate changes and actuarial estimations that increased the workers' compensation expense by $2,242 million, $2,500 million, and $1,343 million for each of the respective years. Discount rates are updated quarterly, based on prevailing market rates for a basket of Treasury securities with maturities corresponding to the expected duration of the future cash payments. Over the course of the last three years, yields on Treasury securities have trended significantly downward, corresponding with the weakness in the global economy. As a result, the present value of our workers' compensation liability has increased substantially, although actual cash outflows have not been as significantly impacted. These increases in the present value of the workers' compensation liability are recorded as operating expenses.

Further, we have incurred expenses of $5.5 billion and $1.4 billion in 2010 and 2009, respectively, for the legally mandated prefunding payments to the PSRHBF at each year-end. We would have also incurred $5.5 billion in 2011 had P.L. 112-33 not been enacted. This law shifted the prefunding payment scheduled to be due by September 30, 2011, into 2012. Due to the shift of that prefunding payment, our 2012 PSRHBF expense will now be $11.1 billion, $5.5 billion more than the previously scheduled $5.6 billion if no further legislation addressing the prefunding payment schedule is passed.

Because expenses related to discount rate changes, the actuarial revaluation of workers' compensation cases, and legislative mandates are not subject to management's control, we believe that analyzing operating results without the impact of these charges provides a more meaningful insight into operations.

The table below illustrates the loss from ongoing business activities when these charges are not considered, and reconciles this amount to our GAAP net loss.

Loss before impact of discount rate changes, actuarial revaluations, and PSRHBF expense (Dollars in Millions)	2011	2010	2009
Net Loss	$ (5,067)	$ (8,505)	$ (3,794)
Impact of:			
Discount rate changes and actuarial revaluation of Workers'	2,242	2,500	1,343
and PSRHBF expense	-	5,500	1,400
Loss before impact of discount rate changes, actuarial revaluations, and PSRHBF expense	**$ (2,825)**	**$ (505)**	**$ (1,051)**

Without the impact of these charges, the net loss would have been $2,825 million in 2011, $505 million in 2010 and $1,051 million in 2009.

Due to the combined effects of decreasing revenue and legislatively mandated costs, we have suffered losses in every quarter since Quarter I, 2008, except Quarter IV, 2011 and Quarter IV, 2009. These two quarters would have also shown losses if P.L. 112-33 and P.L. 111-68 had not reduced those year's retiree health benefits prefunding contributions from $5.5 billion to zero in 2011 and from $5.4 billion to $1.4 billion in 2009. No similar legislation was enacted in 2010 and we therefore made the full $5.5 billion scheduled payment for that year.

Despite these financial challenges, in 2011 we were able to increase operating efficiency. Operating efficiency, as measured by Total Factor Productivity (TFP), increased 1.3% in 2011 and 2.2% in 2010 as compared to the previous year. This marked the tenth year of positive TFP growth since 2000 and cumulative growth of 21.6% since 1972.

Productivity gains are a result of effective workforce management, efficient use of material (supplies and services including transportation), and maximizing the return-on-capital investments (mainly automation). Work hours in 2011 were reduced by 34 million, or 2.9% despite an increase of approximately 636,500 delivery points, while mail volume declined 1.7%.

For the year ended September 30, 2011, operating revenue was $65,711 million, compared to $67,052 million in 2010, a decrease of $1,341 million, or 2.0%, despite an average Mailing Services price increase of 1.7% in April 2011 and Shipping Services price increases of 3.6% and 3.3% in January 2011 and 2010, respectively. There were no price increases for Mailing Services products during 2010.

In 2011, Shipping Services revenue increased by $530 million or 6.3% on a volume increase of 6.0%. However, these increases were not enough to offset a decrease in Mailing Services of $1,871 million or 3.2% driven by decreases in First-Class Mail revenue and volume. The decline in First-Class Mail revenue and volume, our most profitable product, reflects the impact resulting from continuing migration away from First-Class Mail toward electronic alternatives.

Operating expenses in 2011 were $70,634 million, compared to $75,426 million in 2010, a decrease of $4,792 million, or 6.4%. Compensation and benefit expense in 2011 decreased by $599 million, or 1.2%, due primarily to the reduction of 34 million workhours. Due to the passage of P.L. 112-33 and the resulting shift of the scheduled 2011 $5.5 billion annual prefunding of the PSRHBF from 2011 to 2012, total retiree health benefits expenses decreased by $5,306 million, or 68.5% in 2011 from 2010.

Total workers' compensation expenses rose by $106 million, or 3.0%. Included in the total $3,672 million workers' compensation expense is $2,242 million related to changes in the discount rate and the actuarial revaluation of future estimated payments. The discount rate change is further discussed in the "Workers' Compensation" section below and in Note 9*, Workers' Compensation*, in the Notes to the Financial Statements.

Transportation expenses increased $511 million, or 8.7%, driven by sharply higher fuel prices which more than offset decreases in mail volume and higher utilization rates. Other expenses increased $496 million or 5.3%.

As shown in the chart below, total operating expenses would have been $68,392 million in 2011, an increase of $966 million, or 1.4% from 2010 if the impact of the discount rate and actuarial revaluation changes and required PSRHBF prefunding payments are excluded.

Operating Expense before impact of discount rate changes, actuarial revaluations, and PSRHBF expense (Dollars in Millions)	2011	2010	2009
Operating Expenses	$ 70,634	$ 75,426	$ 71,830
Impact of:			
Discount changes and actuarial revaluation of Workers' Compensation	2,242	2,500	1,343
PSRHBF Expense	-	5,500	1,400
Operating Expense before impact of discount rate changes, actuarial revaluations, and PSRHBF expense	**$ 68,392**	**$ 67,426**	**$ 69,087**

For 2010, the net loss was $8,505 million, compared to a $3,794 million net loss in 2009. Operating revenue of $67,052 million in 2010 was 1.5%, or $1,038 million, less than operating revenue of $68,090 million in 2009. The volume of First-Class Mail declined in 2010 compared to 2009 while Standard Mail and Shipping Services volume remained relatively flat.

Operating expenses were $75,426 million in 2010 compared to $71,830 million in 2009, a $3,596 million, or 5.0% increase. Within that increase, two items had significant increases. Total workers' compensation expenses in 2010 rose by $1,343 million, or 60.4%, and retiree health benefits expenses increased by $4,357 million, or 128.5%, primarily due to the $4.1 billion increase in the annual prefunding payment to the PSRHBF.

These increases in workers' compensation and retiree health benefits expenses in 2010 more than offset the $1,974 million, or 3.9%, reduction in compensation and benefit expense in 2010. Work hours decreased by 75 million, resulting in significant savings. Transportation expense decreased $148 million, or 2.5%, as reductions were accomplished without affecting service to our customers and despite the large percentage of costs dedicated to serving our still-growing delivery network.

REVENUE AND VOLUME

Revenue and volume are closely linked to two factors: the strength of the U.S. economy and changes in how our customers use the mail. Historically, the more significant factor has been cyclical changes in the rate of economic growth, versus the rate that relevant new technology has been introduced and accepted into the market place.

The recession that began in the fall of 2007 and its lingering effects, accompanied by the introduction and later acceptance of major new technological platforms, has changed how the internet is used by businesses and consumers. This has had a significant negative impact on our traditional sources of revenue. The fact that these two factors impacted the Postal Service simultaneously magnified the negative impact, as the recession accelerated the shift to electronic alternatives.

Between 2008 and 2010, the American economy experienced its worst economic downturn since the Great Depression and mail volume fell precipitously. The recovery from the recession in 2011 was slow, weak, and uneven. Lingering high unemployment, a weak housing market and low levels of consumer confidence remain a major concern. In the quarter ended September 30, 2011, gross domestic product (GDP) growth stood at 2.5% with the unemployment rate at over 9%. As a result, consumer spending and business investment did not provide the growth stimulus necessary to grow mail volumes in 2011 at the same high levels that the Postal Service experienced in the mid-2000s. However, there were promising signs of growth in certain lines of business.

However, the more important factor affecting 2011 revenues and volumes was the continuing impact that the acceptance of relatively new technology has had on how customers use the mail. Volume and revenue continue to be lost to electronic alternatives and it is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses.

The impact of technological change has been especially hard on our First-Class Mail revenues, which dropped 5.8% on a volume decline of 6.4% in 2011 from 2010 and 16.2% on a volume decline of 23.7% from the 2007 revenue peak. However, electronic diversion is also impacting Standard Mail revenue which grew at a lower-than-expected rate of 2.9% in 2011 as compared to 2010 because advertisers continue to become more selective in targeting their mailings, thus negatively impacting mail volume.

New technology, however, has helped us grow our Package Services and Shipping Services businesses, which showed increased revenues of 4.0% and 6.3% in 2011 as compared to 2010. However, because these two service lines represent only about 16% of our total revenues, these increases cannot fully replace the drops in First-Class Mail revenue, at least in the short-term.

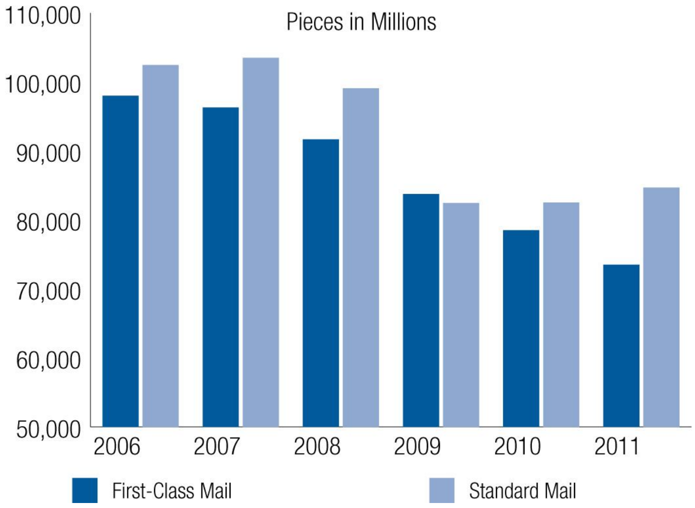
Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the decline in First-Class Mail revenue. In short, no revenue growth solution to the Postal Service's financial problem is currently foreseen.

Mailing Services prices increased an average of 1.7% in April 2011 and 3.8% in May 2009. There were no Mailing Services price increases in 2010. Shipping Services prices increased by an average of 3.6%, 3.3%, and 5.0% in January 2011, 2010, and 2009, respectively.

In August 2011, the PRC approved a new methodology for allocating revenue across service lines. This new methodology was applied to revenue and volume data relating to 2011 and 2010. The new methodology did not change total revenue; however, it has an immaterial impact on volume. It did not impact any data presented below related to mail revenue and volume for 2009.

In the following discussions, the comparison for 2011 to 2010 is made using the new methodology and the comparison for 2010 to 2009 is made using the previous methodology.

Trends in First-Class and Standard Mail Volume



REVENUE AND VOLUME - 2011 COMPARED TO 2010

In 2011, despite strong growth of 6.3% for Shipping Services and 4.0% for Package Services, and lesser growth of 2.9% for Standard Mail, total revenue of $65,711 million in 2011 declined $1,341 million or 2.0% as compared to 2010 due to the continued diversion of the mail from traditional postal services to electronic media. This diversion is primarily impacting First-Class Mail. The rate of decline in total mail volume slowed in 2011 compared to 2010, although the rate of decline in First-Class Mail accelerated slightly.

We anticipate total mail volume will continue to decline in the next few years due to a combination of the continued decline of First-Class Mail volume and relatively flat Standard Mail volume. The expected continued decline of First-Class Mail, our most profitable product, will pose a significant challenge. Other categories of Mailing Services or Shipping Services are not expected to grow significantly enough to replace the revenue and profit margin associated with the decline of First-Class Mail. To compensate for the loss of one piece of First-Class Mail, Standard Mail must increase by three pieces.

The following table indicates mail volume by category:

Mail Volume by Service Line *

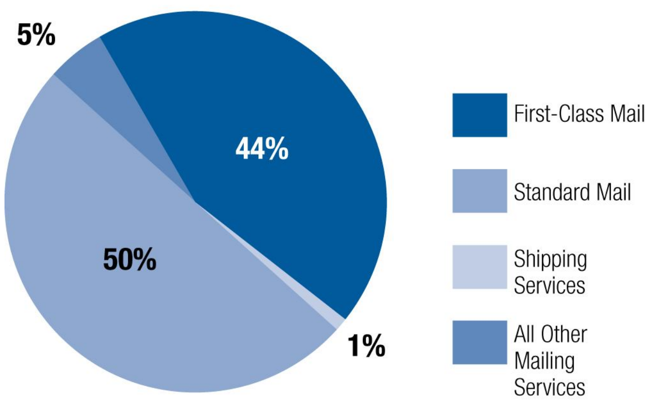
(pieces in millions)	2011	2010
First-Class Mail	73,521	78,514
Standard Mail	84,692	82,525
Periodicals	7,077	7,269
Package Services	675	657
Other Mailing Services^	496	506
Total Mailing Services	**166,461**	**169,471**
Total Shipping Services	**1,473**	**1,389**
Total Mail Volume by Service Line	**167,934**	**170,860**

*Note: In 2011, the PRC approved a new methodology for allocating revenue across service lines. This new methodology was applied to revenue and volume data relating to 2011 and 2010. The new methodology does not change total revenue; however, it has an immaterial impact on volume. These reclassifications did not impact total mail revenue and volume for 2009.

^Includes Certified Mail, Return Receipts, PO Boxes, Insurance, and Other Ancillary Fees

Total mail volume of 168 billion pieces declined by 3 billion pieces, or 1.7%, from the 2010 volume of 171 billion pieces, itself a decline of 6 billion pieces from the 2009 volume of 177 billion pieces.

2011 Mail Volume



Total operating revenue in 2011 was $65,711 million, a decrease of $1,341 million, or 2.0%, compared to 2010 operating revenue of $67,052 million.

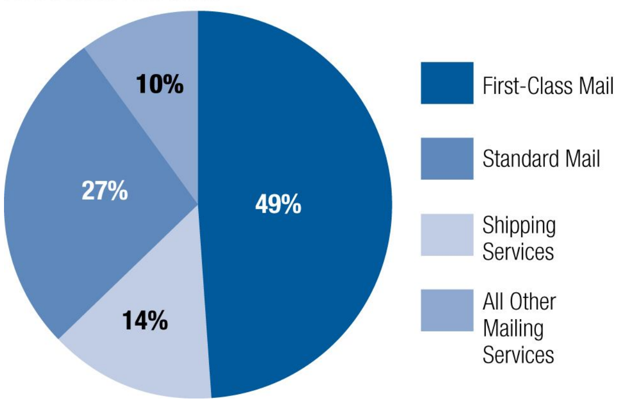
Operating Revenue *

(dollars in millions)		2011		2010
First-Class Mail	$	32,179	$	34,153
Standard Mail		17,826		17,331
Periodicals		1,821		1,879
Package Services		1,606		1,544
Other Mailing Services^		3,285		3,681
Total Mailing Services		**56,717**		**58,588**
Total Shipping Services		**8,994**		**8,464**
Total Operating Revenue	**$**	**65,711**	**$**	**67,052**

*Note: In 2011, the PRC approved a new methodology for allocating revenue across service lines. This new methodology was applied to revenue and volume data relating to 2011 and 2010. The new methodology does not change total revenue; however, it has an immaterial impact on volume. These reclassifications did not impact total mail revenue and volume for 2009.

^Includes Certified Mail, Return Receipts, PO Boxes, Insurance, and Other Ancillary Fees

2011 Mail Revenue



MAILING SERVICES

In 2011, Mailing Services revenue decreased $1,871 million, or 3.2%, with a corresponding volume decrease of 3 billion pieces, or 1.8%, compared to last year. The largest contributing factor to this decline was the continuing migration away from First-Class Mail toward electronic alternatives. An additional factor impacting this decrease was the continuing sluggish economy and lingering effects of the recent recession.

In 2011, revenue from First-Class Mail was $32,179 million, or 5.8% less than 2010, as volume decreased 5 billion pieces, or 6.4%, compared to last year. Single-piece First-Class Mail letter and card revenue declined $1,298 million, or 10.1%, on a volume decrease of 3 billion pieces, or 10.5%, compared to 2010. Revenue from presorted First-Class Mail, which consists largely of bills and statements, decreased by $487 million, or 3.0%, on a volume decrease of 2 billion pieces, or 3.7%. Single-piece First-Class Mail volume, including correspondence, bills, remittances, confirmations, orders, and rebates, continued to decrease and has been in decline for over a decade. As already mentioned, the continued migration of hard-copy mail from traditional postal services to soft copy electronic media is the primary driver behind the continued decline in First-Class Mail volume and revenue.

The modest improvement in the economy helped increase Standard Mail revenue by $495 million, or 2.9%, in 2011 compared to 2010, on a volume increase of 2 billion pieces, or 2.6%. Standard Mail letter volume increased 4.7%, or 2 billion pieces, while revenue increased $500 million, or 5.5%, in 2011 compared to 2010. The volume for Standard Mail flats fell 3.8%, or 266 million pieces, while revenue dropped $88 million, or 3.4%, in 2011 compared to last year. Standard Mail volume was negatively impacted in 2011 as advertisers continued to become more selective in the targeting of their mailings. We expect that advertising mail volume will remain flat because economic growth is not expected to be rapid or robust.

Periodicals revenue decreased $58 million, or 3.1%, from $1,879 million in 2010 to $1,821 million in 2011. Periodicals volume decreased 192 million pieces, or 2.6%, to 7 billion pieces in 2011. Trends in hard-copy reading behavior and shifts of advertising away from print have been depressing this segment for years. Periodicals are not expected to rebound as e-readers and electronic content continue to become popular with the public.

Package Services revenue of $1,606 million in 2011 increased $62 million, or 4.0%, compared to 2010. Volume increased 18 million pieces, or 2.7%, for the same period. Growth in Package Services is attributed to the increased use of ecommerce and to the economical pricing offered by this service line.

SHIPPING SERVICES

Shipping Services, which includes premium products such as Priority Mail and Express Mail, represents less than 1% of volume but generates approximately 14% of revenue. Shipping Services revenue increased by $530 million, or 6.3%, in 2011 to $8,994 million on a volume increase of 84 million, or 6.0%. The increase in revenue was driven by increased mailings of packages as consumers continued to use the internet more often to purchase goods. Our most recent price increases in January 2010 and January 2011 positively impacted our revenues; in addition, the success of our mail advertising campaigns also added to the revenue increase.

REVENUE AND VOLUME - 2010 COMPARED TO 2009

In 2010, total volume was 171 billion pieces versus 177 billion pieces in 2009. Operating revenues of $67,052 million, a $1,038 million, or 1.5%, decline from 2009 reflects the 6 billion piece, or 3.5%, volume decline for that same period.

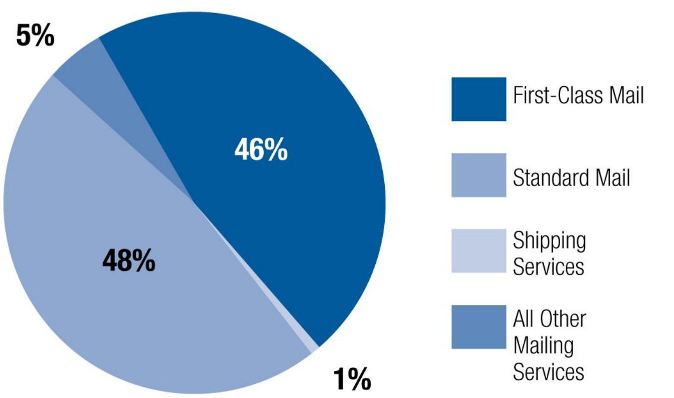
Mail Volume by Service Line *

(pieces in millions)	2010	2009
First-Class Mail	78,203	83,766
Standard Mail	82,525	82,448
Periodicals	7,269	7,901
Package Services	658	731
Other Mailing Services^	499	517
Total Mailing Services	**169,154**	**175,363**
Total Shipping Services	**1,420**	**1,381**
Total Mail Volume by Service Line	**170,574**	**176,744**

*Note: Denotes 2010 volume data under the old methodology of allocating across service lines and provides a comparison to 2009 data, which did not change.

^Includes Certified Mail, Return Receipts, PO Boxes, Insurance, and Other Ancillary Fees

2010 Mail Volume



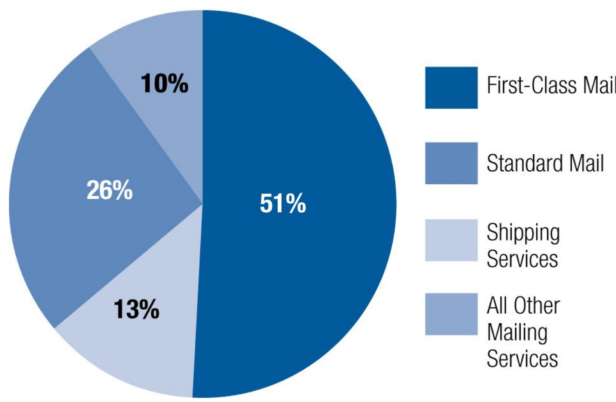
Operating Revenue *

(dollars in millions)		2010		2009
First-Class Mail	$	34,026	$	35,883
Standard Mail		17,331		17,345
Periodicals		1,879		2,038
Package Services		1,516		1,684
Other Mailing Services^		3,619		2,886
Total Mailing Services		**58,371**		**59,836**
Total Shipping Services		**8,681**		**8,254**
Total Operating Revenue	**$**	**67,052**	**$**	**68,090**

*Note: Denotes 2010 revenue data under the old methodology of allocating revenue across service lines and provides a comparison to 2009 data, which did not change.

^Includes Certified Mail, Return Receipts, PO Boxes, Insurance, and Other Ancillary Fees

2010 Mail Revenue



MAILING SERVICES

In 2010, First-Class Mail and Standard Mail made up approximately 94% of volume and 77% of revenue. Total Mailing Services revenue decreased by $1,465 million, or 2.4%, with a corresponding volume decrease of 6 billion pieces, or 3.5% compared to 2009.

First-Class Mail revenue decreased $1,857 million, or 5.2%, from 2009 revenue of $35,883 million. Volume decreased by 6 billion pieces, or 6.6%, in 2010. Single-piece First-Class letters and cards decreased by 3,098 million pieces, or 9.8%, and presorted First-Class Mail decreased by 1,662 million pieces, or 3.5%. The 2010 decrease in First-Class Mail revenue was somewhat mitigated by $210 million earned in 2010 for Census mailings, an event that occurs once a decade.

In 2010, Standard Mail revenue decreased $14 million, or 0.1%, compared with 2009, on a volume increase of 77 million pieces, or 0.1%. Standard Mail volume was significantly impacted by the decline in advertising spending as a result of the recent recession. Standard

Mail letter volume increased 3.2%, or 2 billion pieces, while revenue increased $390 million, or 4.4% in 2010 compared to 2009. The volume for Standard Mail flats fell 10.1%, or 788 million pieces, and the related revenue dropped $289 million, or 10.1% in 2010 compared to 2009.

Periodicals revenue and volume decreased by $159 million and 632 million pieces, or 7.8% and 8.0%, respectively, in 2010 from 2009.

In 2010, Package Services revenue of $1,516 million decreased by $168 million, or 10.0%, compared to 2009, on a volume decline of 73 million pieces, or 10.0%. Volume fell throughout the package industry in 2010 as compared to 2009, reflecting the overall condition of the economy.

SHIPPING SERVICES

In 2010, Shipping Services revenue of $8,681 million increased $427 million, or 5.2%, compared with 2009 revenue of $8,254 million, on a volume increase of 39 million pieces, or 2.8%.

Additional discussion on volume and revenue projections can be found in the "Outlook" section of this report. Detailed data on Mailing Services product volume and revenue may be found in the Quarterly Revenue, Pieces, and Weight reports on *http://about.usps.com/who-we-are/financials/welcome.htm*.

OPERATING EXPENSES

Operating Expenses

(Dollars in millions)	2011	2010	2009
Compensation and Benefits	$ 48,310	$ 48,909	$ 50,883
Retiree Health Benefits	2,441	7,747	3,390
Workers' Compensation	3,672	3,566	2,223
Transportation	6,389	5,878	6,026
Other Expenses	9,822	9,326	9,308
Total Operating Expenses	**$ 70,634**	**$ 75,426**	**$ 71,830**

In 2011, total operating expenses decreased by $4,792 million, or 6.4% to $70,634 million. This decrease was primarily due to the rescheduling of the $5.5 billion 2011 PSRBHF prefunding payment which was due by September 30, 2011, into 2012 as a result of P.L. 112-33. In addition, a reduction of approximately 27,000 career employees and 34 million work hours during 2011 from 2010 resulted in lower compensation and benefits expenses.

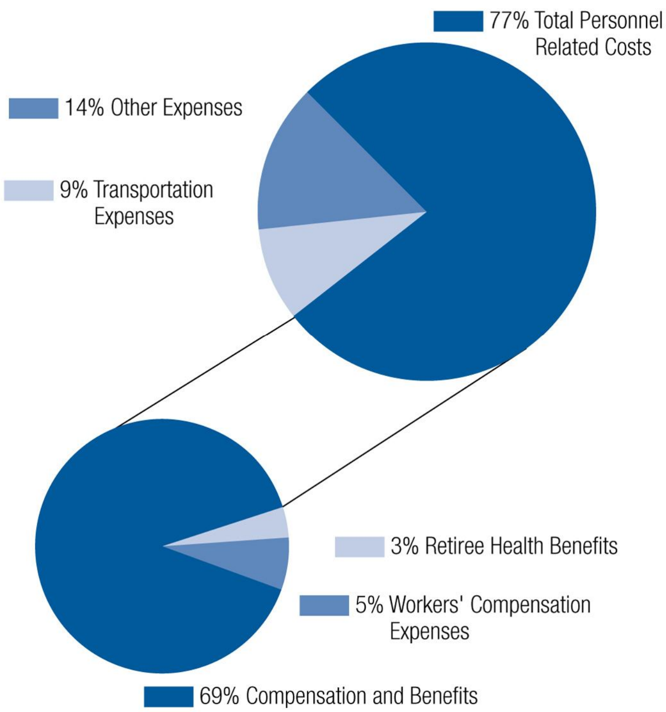
Operating Expense before impact of discount rate changes, actuarial revaluations, and PSRHBF expense

(Dollars in Millions)	2011	2010	2009
Operating Expenses	$ 70,634	$ 75,426	$ 71,830
Impact of:			
Discount changes and actuarial revaluation of Workers' Compensation	2,242	2,500	1,343
PSRHBF Expense	-	5,500	1,400
Operating Expense before impact of discount rate changes, actuarial revaluations, and PSRHBF expense	**$ 68,392**	**$ 67,426**	**$ 69,087**

However, if the impact of the required PSRHBF prefunding payments and discount rate and actuarial changes on workers' compensation were excluded, operating expenses would have been $68,392 million, $67,426 million and $69,087 million in 2011, 2010 and 2009, respectively. Despite decreases in compensation and benefits expenses in 2011 as compared to 2010, the adjusted operating expenses increased in 2011 due to the impact of higher fuel prices, higher costs of new workers' compensation cases, and higher litigation expenses as compared to the prior year.

Compensation and benefits expenses represented 68%, 65%, and 71% of total operating expenses for 2011, 2010, and 2009 respectively. However, when workers' compensation and retiree health benefits, including the legally mandated prefunding of the retiree health benefits, are added, total personnel cost increases to 77%, 80%, and 79% of total operating expenses for 2011, 2010, and 2009 respectively. Although many significant steps have been taken to decrease compensation and benefits costs in response to declining mail volume, many of these costs remain fixed and beyond the Postal Service's control. Contracts with postal unions are negotiated for a fixed period of time, usually three to five years. They cannot be modified during the contract period except by mutual consent. Retirement benefits are not determined by management but rather by the federal government, and health insurance premiums, also managed by the federal government, continue to rise well above the rate of inflation. In addition, the Postal Service's ability to adjust its workforce and network infrastructure is limited by contractual, statutory, regulatory and political obstacles.

Operating Expenses



In 2011, compensation and benefits costs of $48,310 million decreased $599 million or 1.2%, driven by the reduction of 34 million work hours.

The reductions in compensation and benefits expenses in 2011 were not enough to offset increases in transportation, workers' compensation, and other expenses. Transportation expenses increased $511 million, or 8.7%, driven by higher fuel costs. Workers' compensation increased $106 million, or 3% driven by higher claims in 2011 as compared to 2010. In addition, and similar to 2010, significant changes in interest and inflation rates during 2011 had a significant negative impact on total workers' compensation expense, especially when compared to the comparable amounts expensed for changes in inflation and discount rates in 2009. Other operating expenses were negatively impacted by significantly higher litigation expenses incurred in 2011 compared to 2010.

In 2010, total operating expenses of $75,426 million were $3,596 million, or 5%, greater than 2009 operating expenses of $71,830 million. Retiree health benefits increased by $4,357 million in 2010 compared to 2009, primarily due to an increase in the PSRHBF prefunding payment to $5.5 billion, up from $1.4 billion in 2009. Compensation and benefits expense decreased in 2010 by $1,974 million, or 3.9%, from $50,883 million in 2009 to $48,909 million in 2010. The decrease was primarily due to a 75 million reduction in work hours. Transportation expenses decreased by $148 million, or 2.5%, and other expenses increased by $18 million in 2010 compared to 2009.

COMPENSATION AND BENEFITS

Total compensation and benefits expenses of $48,310 million declined $599 million, or 1.2%, in 2011, primarily due to the reduction of nearly 27,000 career employees and a reduction of 34 million work hours.

Compensation expenses in 2011 decreased by $724 million, or 1.9%, from $37,545 million in 2010 to $36,821 million, due to the above-mentioned decline in the number of employees and work hours. Partially offsetting the savings generated by the decrease in work hours was a 1% increase in the average hourly wage as well as an 8.4% increase in the number of overtime hours worked by employees. Since 2000, we have reduced total work hours by a cumulative total of 477 million work hours, equivalent to a reduction in annual expense of $20 billion. We are beginning to reach the limits of the reductions that can be accomplished within the existing network structure and service standards. Accordingly, in 2012, we are proposing a major realignment of our mail processing and distribution network that will allow us to achieve significantly greater reductions.

Compensation and Benefits Expenses

(Dollars in millions)	2011	2010	2009
Compensation	$ 36,821	$ 37,545	$ 39,160
Retirement	5,879	5,809	5,917
Health Benefits	5,222	5,141	5,294
Other	388	414	512
Total Compensation and Benefits Expenses	**$ 48,310**	**$ 48,909**	**$ 50,883**

The contracts (the NRLCA contract, as previously noted, has expired) with the four labor unions representing the majority of our employees currently include provisions granting Cost–of-Living Adjustments (COLA), which are linked to the Consumer Price Index – Urban Wage Earners and Clerical Workers (CPI-W). The most recent COLA effective in September 2011 conferred an annual pay increase of approximately $980 on each eligible employee covered by NPMHU and NALC collective bargaining agreements with an overall annual financial impact of approximately $300 million. The new APWU contract included no COLA increases in 2011. There were no COLA increases in 2010 or 2009. Because the NRLCA contract expired on November 20, 2010, employees covered by that agreement received no COLA increases in 2011.

Nonbargaining unit employees may receive pay increases through a pay-for-performance program that makes meaningful distinctions in performance. Nonbargaining salary rates were frozen in 2011, meaning that nonbargaining employees will not receive pay increases in 2012. These employees do not receive automatic salary increases, nor do they receive COLAs or locality pay.

Retirement expenses for current employees, which consist of accrued employer contributions to the Federal Employees Retirement System (FERS) and Social Security, increased by $70 million, or 1.2%, and current employees' health benefits expense increased $81 million, or 1.6%, from the prior year. The increase in retirement expense was driven by an OPM mandated increase in the FERS contribution rate from 11.2% in 2010 to 11.7% in 2011. The increase in health benefits reflects rising healthcare premium costs. Both these expenses increased despite the reduction of approximately 27,000 career employees.

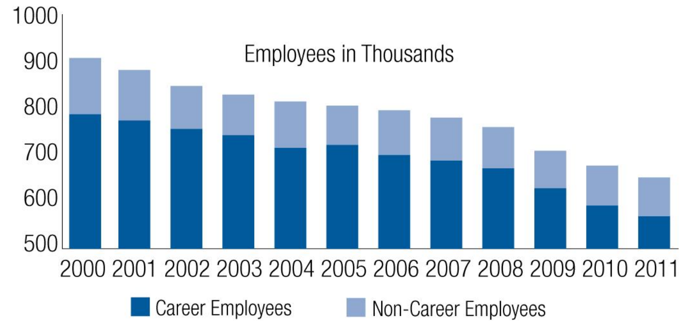
Beginning on June 24, 2011, management and the Board decided to suspend employer contributions to the FERS retirement fund as a cash-conservation measure and because the Postal Service believes that it has adequately met all funding obligations to the FERS at least through September 30, 2012. Although we have suspended the payments, we continue to accrue these expenses. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer's contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011. However, we continue to seek a refund of the overfunded balance.

In 2010, total compensation and benefits expenses declined by $1,974 million, or 3.9%, from 2009 compensation and benefit expense of $50,883 million. In 2010, compensation expenses was $37,545 million compared to $39,160 million in 2009, a $1,615 million, or a 4.1% decrease. The 2010 decrease in compensation expense was driven by a 75 million work hour reduction partially offset by a $112 million incentive expense for approximately 7,400 APWU and NPMHU employees who elected to retire or resign from the Postal Service in Quarter I, 2010. In 2011, a similar incentive was paid to approximately 1,850 administrative employees who elected to retire in Quarter III, 2011, but the amount accrued was not material to the total compensation expense.

EMPLOYEE WORKFORCE

The total number of employees at September 30, 2011, was 645,950, of which approximately 557,250 were career employees. There has been a reduction in the total number of career employees by 26,657, or 4.6% since September 30, 2010. Since the end of 2008, the number of career employees has been reduced by approximately 106,000, or 16%. These reductions have been accomplished primarily through attrition and incentives to retire or resign. The following graph details the decline in numbers of our total workforce, primarily among career employees. For the last three fiscal years, the number of noncareer employees remained relatively stable at an average of approximately 88,500.

Number of Employees



WORK HOURS

Total work hours in 2011 of 1,149 million hours decreased by 34 million, or 2.9%, from 1,183 million work hours in 2010. Work hours in 2010 and 2009 decreased by 75 and 115 million hours, respectively, from the 2009 total of 1,258 million hours, and the 2008 total of 1,373 million hours. These reductions were driven by continued efforts to respond to the decline in mail volume. These efforts included streamlining area and district offices, offering the previously mentioned incentives for employees to retire or resign, and adjusting delivery routes.

Work hours decreased in all major functions in 2011 compared to 2010 except for rural delivery, which remained relatively flat. City delivery declined by 9 million hours or 2.3%; mail processing declined by 9 million hours or 4.2%; and customer service operations declined by 10 million hours or 6.5%.

Workhours by Function

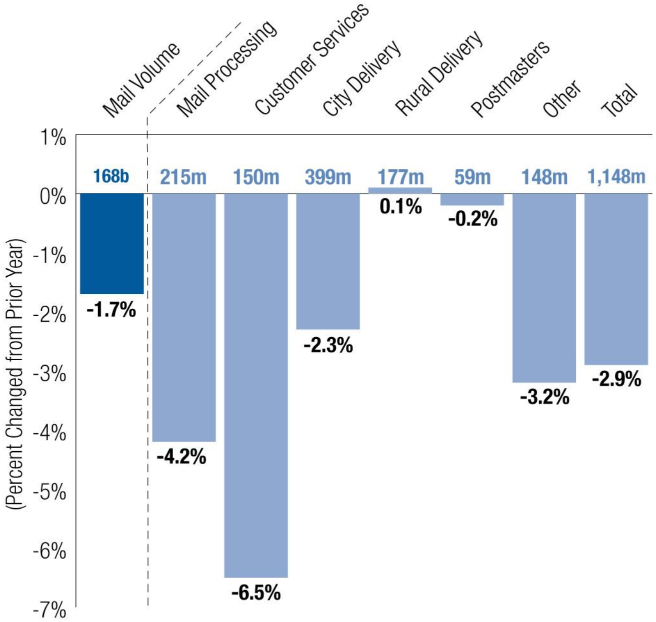
(Workhours in thousands)	2011	2010	2009
City Delivery	399,010	408,488	424,683
Mail Processing	215,221	224,645	251,200
Rural Delivery	177,384	177,152	181,090
Customer Service Operations	150,203	160,621	178,715
Postmasters	59,484	59,609	59,995
Other, including Retail, Vehicle Services, Plant, Operational Support, and Administration	147,535	152,432	162,342
Total Workhours	**1,148,837**	**1,182,947**	**1,258,025**

Total work hours decreased in 2011 despite the addition of approximately 636,500 delivery points. The work hour decreases reflect delivery optimization initiatives and the reduction in mail volume from the previous year. The growth rate of new delivery points has slowed in recent years due to the weak economy, with lower housing starts.

As shown in the following chart, and consistent with last year, in 2011 the rate of reduction in work hours exceeded the rate of decline in mail volume in every category except rural delivery and postmasters. Rural delivery accounts for most of the delivery point growth while postmasters' costs are relatively fixed in the short term. We continually strive to optimize the use of personnel and minimize variable costs. The challenge that remains is to reduce the fixed labor costs. This will require structural changes, many of which need legislative or regulatory approval.

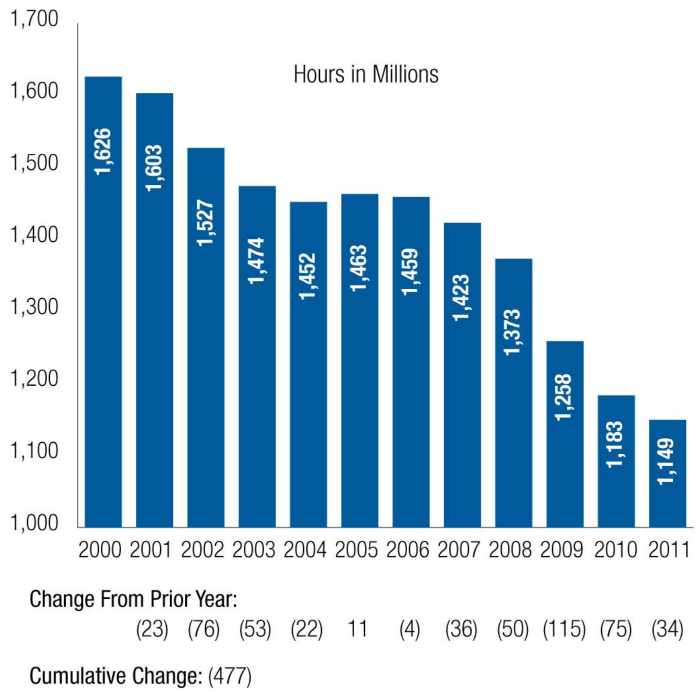
In an effort to aggressively address those areas over which we have the most control, in September 2011, we announced a proposal for a major realignment of our mail processing and distribution network. This would eliminate mail processing at up to 250 locations. This Network Optimization initiative will be the most significant change in our processing and distribution network ever. As part of this initiative, we are proposing a substantially nationwide change in market-dominant service standards, which requires that we request a non-binding advisory opinion from the PRC. We expect to request a non-binding advisory opinion in December 2011. If implemented, the resulting service changes will allow for significant operational efficiency and facility consolidation. This will allow us to make significant additional workforce reductions, beginning in 2012.

Work Hours and Mail Volume Change Comparison



Our 2010 work hours decreased by 75 million, partially offsetting higher labor rates. The 75 million, or 6.0%, decrease in work hours resulted from 2010 management initiatives and delivery route adjustments made in large part due to continuing reductions in mail volume which had begun in previous years. Work hours decreased in all major functions.

Total Work Hours 2000–2011



Work hours have been reduced in ten of the last eleven years, with only 2005 showing a slight increase. Since 2002, work hour reductions have been the single biggest contributor to the ongoing achievement of savings targets.

RETIREMENT EXPENSE

Postal Service employees participate in one of three retirement programs of the U.S. Government, based on the starting date of employment with the federal government. These programs are the Civil Service Retirement System (CSRS), Dual CSRS/Social Security System (Dual CSRS), and the Federal Employees Retirement System (FERS). These programs are administered by the Office of Personnel Management (OPM). The funding requirements and timing of employer and employee contributions to the programs can be altered at any time with the enactment of a new law, regulation, or an amendment of existing law. See Note 8, *Retirement Programs*, in the Notes to the Financial Statements for additional information.

All expenses of the retirement programs, except for retiree health benefits, are included in compensation and benefits expense. Retirement expense of $5,879 million for current employees in 2011 was $70 million, or 1.2%, more than the 2010 expense of $5,809 million. The growth, despite a decrease in the number of employees, is a result of the increase in the required agency contribution to the FERS retirement plan. The FERS agency contribution rate in 2011 was 11.7%, compared to 11.2% in 2010. The 0.5% increase in the FERS contribution rate resulted in an additional $130 million of retirement expenses in 2011 over 2010. This contribution rate will increase again in 2012 to 11.9%. Additionally, the percentage of employees in the FERS plan increased to 85.0% in 2011 from 83.6% in 2010.

On June 24, 2011, the Postal Service suspended its employer's contributions to OPM for the defined benefit portion of its FERS funding requirement. This action was necessary in order to help provide sufficient liquidity to fund Postal Service operations in light of continued weakness in mail volumes and the significant uncertainty regarding legislative reforms. Additionally, the Postal Service overfunded its FERS obligations by $6.9 billion at September 30, 2009, and sought to apply that overfunded balance to amounts currently due for employer contributions. OPM's most recent calculation shows that the FERS surplus has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer's contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011. However, we continue to seek a refund of the overfunded balance.

Retirement expense for current employees decreased in 2010 by $108 million or 1.8% less than the 2009 expense of $5,917 million due to the decreasing size of the work force in 2010. Retirement expense was 8.3%, 7.7%, and 8.2% of total operating expenses in 2011, 2010, and 2009, respectively.

In January 2010, the Office of Inspector General (OIG) issued a report in which it evaluated the funding of the Postal Service's CSRS responsibility, concluding that the Postal Service had overfunded its obligation by $75 billion. At the Postal Service's request, the PRC initiated an independent actuarial review of this issue and issued a report in June 2010 in which the independent actuary determined that, although the cost allocation methodology used in 1971 was appropriate at the time, modern actuarial and accounting guidance suggest that an alternative allocation methodology would be more fair and equitable. If an updated allocation methodology were employed, the PRC's independent actuary estimates that the Postal Service may have overfunded its CSRS obligation by $50 billion to $55 billion.

On October 13, 2011, the U.S. Government Accountability Office (GAO) released its report, *Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*. While the Postal Service appreciates GAO's observation that reallocation of the CSRS pension surplus would not, by itself, solve the organization's financial problems, we are disappointed that the report rejects the findings of two independent actuaries. We believe the GAO report does not address the core question about whether the current allocation of costs is fair and equitable and we continue to contend that, under current law, OPM is in no way precluded from affecting a more equitable split. We also contend that a more balanced report from GAO would be one containing a more objective analysis and would provide more compromise options for Congress to consider.

OPM and GAO agree that, using the long-term funding assumption of the CSRS Board of Actuaries, the Postal Service's portion of the FERS program was overfunded by $6.9 billion as of September 30, 2009 ($10.9 billion at September 30, 2010, according to OPM); however, it is OPM's position that they are currently restricted by law from authorizing the return of those funds. As a result, various legislative initiatives have been introduced to resolve the matter. See the *"Legislative Update"* later in this report.

As described in Note 3, Summary of Significant Accounting Policies, in the Notes to the Financial Statements, we account for participation in the retirement programs of the U.S. Government under multiemployer plan accounting rules. Although the Civil Service Retirement and Disability Fund (CSRDF) is a single fund and does not maintain separate accounts for individual agencies, P.L. 109-435 requires certain disclosures regarding obligations and changes in net assets as if the funds were separate. The following information is provided by OPM and represents the most recent actual data available, which is as of September 30, 2010, with projections to September 30, 2011.

FUNDING STATUS

As required by P.L. 109-435, the Postal Service discloses OPM-provided information regarding the costs and changes in obligations related to the FERS and CSRS retirement programs. We have reported this information based on OPM-provided actuarial valuations, the same valuations that are used by the Board of Actuaries to establish the normal cost and funding requirements for these retirement programs. The OPM actuarial valuations utilize the long-term economic assumptions established by the Civil Service Retirement System Board of Actuaries. This information provides valuable insight concerning our current funding status and the outstanding obligations of the CSRS and FERS programs.

The Postal Service believes that the most appropriate basis for evaluating the funded status of its obligation to CSRS and FERS is to use the actuarial valuations based on the long-term funding assumptions established by the Civil Service Retirement System Board of Actuaries, since these provide the legally mandated basis for determining the appropriate funding of both programs.

The following table provides OPM's estimation of the funded status of the CSRS and FERS programs for Postal Service participants as of September 30, 2010, and 2009, and the projected Postal Service status as of September 30, 2011.

Present Value Analysis of Retirement Programs as calculated by OPM (9/30/10 latest actual data available)

(Dollars in billions)

CSRS	Projected 2011	2010	2009
Actuarial Accrued Liability 9/30	$ 193.3	$ 193.0	$ 202.6
Current Fund Balance	195.0	194.6	195.3
(Unfunded)/Surplus	**$ 1.7**	**$ 1.6**	**$ (7.3)**

FERS	Projected 2011	2010	2009
Actuarial Accrued Liability 9/30	$ 75.9	$ 69.9	$ 68.3
Current Fund Balance	87.3	80.8	75.2
Surplus	**$ 11.4**	**$ 10.9**	**$ 6.9**

* assumes full payment of all USPS FERS contributions

TOTAL CSRS and FERS	Projected 2011	2010	2009
Actuarial Accrued Liability 9/30	$ 269.2	$ 262.9	$ 270.9
Current Fund Balance	282.3	275.4	270.5
Surplus / (Unfunded)	**$ 13.1**	**$ 12.5**	**$ (0.4)**

NET PERIODIC COSTS

Information about the net periodic costs for the CSRS and FERS pension plans, which is prepared by OPM, is as follows:

Components of Net Periodic Costs as calculated by OPM (9/30/10 latest actual data available)

(Dollars in billions)

CSRS	Projected 2011	Actual 2010
Actuarial Liability as of October 1	$ 193.0	$ 202.6
+ Expected Contributions*	0.3	0.4
- Expected Benefit Disbursements	(10.9)	(10.7)
+ Interest Expense	10.9	10.1
+ Total Actuarial Loss during FY	-	(9.4)
Actuarial Liability as of September 30	**$ 193.3**	**$ 193.0**

FERS	Projected 2011	Actual 2010
Actuarial Liability as of October 1	$ 69.9	$ 68.3
+ Normal Cost	3.2	3.5
- Expected Benefit Disbursements	(1.3)	(1.1)
+ Interest Expense	4.1	3.7
+ Total Actuarial Loss during FY	-	(4.5)
Actuarial Liability as of September 30	**$ 75.9**	**$ 69.9**
Total Actuarial Liability as of September 30	**$ 269.2**	**$ 262.9**

* Expected contributions for CSRS consists of employee contributions only.

COST METHODS AND ASSUMPTIONS

- The actuarial cost method used to estimate the liability is Aggregate Entry Age Normal.
- Long-term economic assumptions are as follows:
  - Rate of inflation — 3.0%.
  - COLA —
    Long-Term— 2.4% for CSRS,
    2.4% for FERS
    2011 — 0.0% for CSRS and FERS
  - Annual general salary increases —
    Long Term - 3.75%
    2011 and 2012 - 0.0%.
  - Interest rate — 5.75% for CSRS. 5.75% for FERS.

- On June 24, 2011, USPS suspended employer's FERS contributions. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer's contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011.

COMPONENTS OF NET CHANGE IN PLAN ASSETS

The following table prepared by OPM shows the components of the net change in plan assets for the CSRS and FERS programs.

Analysis of Change in Pension Net Assets as calculated by OPM
(9/30/10 latest actual data available)

(Dollars in billions)

CSRS	Actual 2010	Actual 2009
Net Assets as of October 1*	$ 195.3 *	$ 195.0
+ Contributions	0.4	0.5
- Benefit Disbursements	(10.7)	(10.1)
+ Investment Income	9.6	9.9
Net Assets as of September 30	**$ 194.6**	**$ 195.3**

OPM restated September 30, 2009 CSRS net assets from $195.329 to $195.293

FERS	Actual 2010	Actual 2009
Net Assets as of October 1	$ 75.2	$ 69.3
+ Contributions	3.1	3.2
- Benefit Disbursements	(1.1)	(1.0)
+ Investment Income	3.6	3.7
Net Assets as of September 30	**$ 80.8**	**$ 75.2**
CSRS and FERS Net Assets at September 30	**$ 275.4**	**$ 270.5**

As noted previously, CSRDF is a single fund and does not maintain separate accounts for individual employer agencies. The actual securities of the CSRDF are not allocated separately to CSRS or FERS, or to postal and non-postal beneficiaries. The assets of the CSRDF are composed entirely of special-issue Treasury securities with maturities of up to 15 years. The long-term securities bear interest rates ranging from 2.50% to 6.875%, while the short-term securities bear interest rates of 1.875%.

The assumed rates of return on the CSRS fund balance for 2010 and 2009 were 5.75% and 6.25% respectively, and the actual rates of return were 5.10% and 5.23%, respectively. For the FERS fund, the assumed rates of return for 2010 and 2009 were 5.75% and 6.25% respectively, while the actual rates of return were 4.77% for 2010 and 5.18% for 2009. The projected rate of return on the CSRS and FERS fund balance for 2011 is 5.75%.

OPM estimates the contributions and benefit payments for the next five years as follows:

Projection of CSRS and FERS Contributions and Benefit Payments* as calculated by OPM

(Dollars in billions)

	CSRS		FERS	
	Contributions	Total Benefit Payments	Contributions	Total Benefit Payments
2011	$ 0.3	$ 12.2	$ 3.2	$ 1.3
2012	0.3	12.5	3.1	1.5
2013	0.2	12.8	3.1	1.7
2014	0.2	13.1	3.0	1.9
2015	0.2	13.3	3.0	2.2

** Assumes total employee population remains constant.*

HEALTH BENEFITS

Postal employees and retirees may participate in the Federal Employees' Health Benefit Program (FEHBP), which is administered by OPM. The Postal Service accounts for current employee and retiree health benefit costs as an expense in the period the contribution is due. For retiree health benefits, multiemployer plan accounting rules are used.

The drivers of active employee healthcare expense are the number of employees electing coverage and the premium costs of the selected plans. On average, the Postal Service paid 79% of the premium cost in 2011 and employees paid the remainder. The average employer contribution was 80% in 2010 and 81% in 2009. We expect the Postal Service contribution to health benefit premiums to continue to decrease in the future, until they reach the average for the remainder of the federal government. The total premium cost for each plan is determined annually by OPM. In September 2011, OPM announced average premium increases of 3.8% for calendar year 2012. Previous increases were 7.2% in 2011, 8.8% in 2010, and 7.0% in 2009.

Total health benefit expenses were $5,222 million, an increase of $81 million, or 1.6%, in 2011 compared to 2010. The 2011 average premium increase of 7.2% drove the increase in health benefit expense which was partially offset by a lower number of employees in 2011 compared to 2010. The 2010 expense of $5,141 million was a decrease of $153 million, or 2.9%, from the 2009 health benefits expense of $5,294 million. Employee health benefits expense was 7.4%, 6.8%, and 7.4% of total operating expenses in 2011, 2010, and 2009, respectively.

RETIREE HEALTH BENEFITS

Eligible employees, those with at least five consecutive years of participation in the FEHBP immediately preceding retirement, are entitled to continue to participate in FEHBP after retirement. The amount due the PSRHBF for prefunding in any given year, plus our portion of the current premium expense for retirees, is recognized as an expense when due.

P.L. 109-435 made several changes to the way we fund and report the obligation for post-retirement health benefits. The law established the PSRHBF, and initially directed that we make annual prefunding payments of between $5.4 billion to $5.8 billion per year through 2016 into this fund. Although P.L. 109-435 specifies the funding requirements through 2016, the amounts to be funded and the timing of the funding can be changed at any time with enactment of a new law or upon amendment of an existing law. The prefunding amount has been amended three times, as noted below.

On October 1, 2009, P.L. 111-68 became law and decreased the scheduled 2009 payment by $4.0 billion — from $5.4 billion to $1.4 billion. This law affected only the 2009 payment and did not change any future payment requirements. On September 30, 2011, P.L. 112-33, the *Continuing Appropriations Act, 2012,* became law. It deferred the required PSRHBF payment of $5.5 billion previously scheduled to be due by September 30, 2011, to be due by October 4, 2011. P.L. 112-36, the *Continuing Appropriations Act, 2012,* extended the October 4 deferral date to be due by November 18, 2011. As a result, the total 2012 required payment is $11.1 billion: $5.5 billion due by November 18, 2011, and $5.6 billion due by September 30, 2012. To date, none of the law changes have altered the payment requirements for the original $5.6 billion due by September 30, 2012, or for the 2013 to 2016 scheduled payments. See Note 7, *Health Benefit Programs*, for additional information.

Under the current law, not later than 2017, OPM will conduct an actuarial valuation and determine whether any further payments into the fund are required. If additional payments are required, OPM will design an amortization schedule to fully amortize the remaining liability, if any, by 2056. Beginning in 2017, the PSRHBF will begin to pay the Postal Service's portion of the retiree health premiums. Also beginning in 2017, we will fund the actuarially determined normal cost, plus any required amortization of the unfunded liability.

As mentioned above, in 2011, there were no payments to the PSRHBF. In 2010 and 2009 payments to the PSRHBF were $5.5 billion and $1.4 billion, respectively.

Under P.L. 109-435, OPM continues to charge us for the premiums for postal retirees participating in FEHBP, and we continue to expense these payments as they become due, until 2017. The major drivers of retiree health benefits premium costs are the number of retirees and survivors on the rolls, the mix of plans selected by retirees, the premium costs of those plans, and the apportionment of premium costs to the federal government for retiree service prior to 1971. Retiree health benefit premium expense, exclusive of the expense for prefunding the PSRHBF, has increased every year. Retiree health benefits premium expense increased 8.6% in 2011, 12.9% in 2010 and 10.1% in 2009. The number of Postal Service annuitants and survivors participating in FEHBP was approximately 469,000 in 2011, compared to 473,000 in 2010 and 463,000 in 2009. The average monthly apportionment, the percentage of retiree premiums charged to the Postal Service, has increased from 72.0% in 2009, to 74.9% in 2010, and to 76.5% in 2011.

The following table shows the components of retiree health benefits expense for 2011, 2010, and 2009.

Retiree Health Benefits

(Dollars in millions)	2011	2010	2009
Retiree Health Benefits Premiums	$ 2,441	$ 2,247	$ 1,990
P.L. 109-435 Payment to PSRHBF	-	5,500	1,400
Total Retiree Health Benefits	**$ 2,441**	**$ 7,747**	**$ 3,390**

PSRHBF

P.L. 109-435 requires that OPM provide, and that we report, certain information concerning the obligations, costs, and funded status of the PSRHBF. The following table is based upon information provided by OPM and shows the funded status and components of net periodic costs.

Postal Service Retiree Health Benefit Fund Funded Status and Components of Net Periodic Costs as calculated by OPM *

(Dollars in millions)	2011	2010
Beginning Actuarial Liability at October 1	$ 91,059	$ 87,472
- Actuarial Gain	(5,360)	(1,600)
+ Normal Costs	2,879	3,055
+ Interest @ 4.9% and 5.1%, respectively	4,200	4,379
Subtotal Net Periodic Costs	**1,719**	**5,834**
- Premium Payments	(2,441)	(2,247)
Actuarial Liability at September 30	**90,337**	**91,059**
- Fund Balance at September 30	(44,118)	(42,492)
Unfunded Obligations at September 30	**$ 46,219**	**$ 48,567**

* The 2011 medical inflation assumption was 5.5% as of the valuation date and grades down to an ultimate value of 4.4%. The 2010 medical inflation assumption was 7.5% and grades down to an ultimate value of 4.5%.

The OPM valuation of post-retirement health liabilities and normal costs was prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 5 and SFFAS No. 33, which require the use of the aggregate entry age normal actuarial cost method.

Demographic assumptions and an interest rate assumption of 4.9% are consistent with the pension valuation assumptions, and decrements are based upon counts or numbers rather than dollars.

The normal cost, which is on a per-participant basis, is computed to increase annually by a constant medical inflation rate which is assumed to be 5.5% per annum as of the valuation date and trend down to an ultimate value of 4.4%. Past-year medical inflation was assumed to be 7.5% grading down to an ultimate value of 4.5%. Normal costs are derived from the current FEHBP on-roll population with an accrual period from entry into FEHBP to assumed retirement. Entry into the FEHBP is generally later than entry into the retirement systems.

The accrued liability is equal to the total liability less future normal cost payments. The amounts used in these valuations use the same methodology and assumptions as for OPM's financial statements except that the average government share of premium payments for annuitants is substituted for annuitant medical costs less annuitant premium payments. This amount is assumed to increase at 5.5% per annum as of the valuation date and trend down to an ultimate value of 4.4%. For current postal annuitants, the government share of premium payments is adjusted to reflect the pro-rata share of civilian service to total service for which the Postal Service is responsible. The pro-rata adjustment is made by applying calculated factors based upon actual payments that vary by the age and Medicare status of the enrollments. For active postal employees, the pro-rata share in retirement is assumed to be 93% of the total.

The following table shows the net assets of the PSRHBF:

Net Assets of Postal Service Retiree Health Benefit Fund (as calculated by OPM)

(Dollars in millions)

	2011	2010
Beginning Balance at October 1	$ 42,492	$ 35,482
Contributions and Transfers	-	5,500
Earnings at 3.8% and 4.2%, respectively	1,626	1,510
Net increase	1,626	7,010
Fund Balance at September 30	**$ 44,118**	**$ 42,492**

The assets of the PSRHBF are comprised entirely of long-term special-issue Treasury securities with maturities of up to 15 years. The long-term securities bear interest rates ranging from 2.50% to 5.00%. The expected rate of return was 4.9% for 2011 and 5.1% for 2010 and the actual rates of return were 3.8% for 2011 and 4.2% for 2010.

Because calculation of this liability involves several areas of judgment, estimates of the liability could vary significantly depending on the assumptions used. Utilizing the same underlying data that was used in preparing the estimate in the table above, the September 30, 2011, unfunded obligation could range from $34 billion to $60 billion, solely by varying the inflation rate by plus or minus 1%, and the 2010 unfunded obligation would range from $37 billion to $62 billion.

5-Year Projection of PSRHBF Contributions and Benefit Payments

(Dollars in millions)

	Contributions	Payments *
2012	$ 11,100	$ -
2013	5,600	-
2014	5,700	-
2015	5,700	-
2016	5,800	-

* Under current law, payments from PSRHBF will not begin until the year 2017.

WORKERS' COMPENSATION

Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the Department of Labor's (DOL) Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. However, we annually reimburse the DOL for all workers' compensation benefits paid to or on behalf of postal employees, and pay an administrative fee to DOL.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon currently open claims and past claim-payment experience.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The liability for claims arising more than 10 years ago is determined by an independent actuary. The existing FECA benefit structure is often superior to benefits available under normal federal retirement, and these more lucrative payments will, in some cases, be for the rest of the lives of the claimants.

The liability for estimated future workers' compensation payments is recorded at its present value. To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at the balance sheet date in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the September 30, 2011, liability and 2011 expense by approximately $1,500 million. A decrease of 1% in the discount rate would increase the September 30, 2011, liability and 2011 expense by approximately $1,900 million.

At September 30, 2011, the present value of the liability for future workers' compensation payments was $15,142 million, compared to $12,589 million at September 30, 2010, an increase of $2,553 million. In 2011, we made payments of $1,100 million to the DOL. The current portion of the liability was $1,255 million at September 30, 2011, compared to $1,115 million at September 30, 2010. At September 30, 2010, our liability increased $2,456 million, or 24.2%, from September 30, 2009.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases and the progression of existing cases. The impact of changes in discount and inflation rates accounted for $978 million and $2,017 million of the 2011 and 2010 expense, respectively.

Beginning in Quarter III, 2009, we experienced a significant change in the discount and inflation rates used to estimate the workers' compensation liability. The economic recession that began in December 2007 and corresponding response by the Federal Reserve resulted in interest rates declining significantly. GAAP requires us to use discount rates based on the best available information at the measurement date. Accordingly, discount rates used in estimating the present value of the workers' compensation liability decreased in 2009, 2010, and 2011. Since 2008, over $3.7 billion of the growth in the workers' compensation liability is attributable solely to the impact of discount and inflation rate changes.

The inflation and discount rates used to estimate our liability at September 30, 2011, 2010, and 2009, are shown in the following table.

Workers' Compensation Liability Inflation and Discount Rates	**September 30, 2011**	**2010**	**2009**
Compensation Claims Liability			
Discount Rate	2.3%	2.9%	4.9%
Wage Inflation	2.9%	2.9%	3.2%
Medical Claims Liability			
Discount Rate	2.4%	3.0%	4.4%
Medical Inflation	8.6%	7.4%	3.8%

In 2011, workers' compensation expense was $3,672 million, an increase of $106 million, or 3.0% compared to 2010. The 2010 expense of $3,566 million increased $1,343 million, or 60.4% from 2009. The components of workers' compensation expense are as follows:

Workers' Compensation Expense (Dollars in millions)	**Years Ended September 30, 2011**	**2010**	**2009**
Impact of discount & inflation rate changes	$ 978	$ 2,017	$ 718
Actuarial revaluation of existing cases	1,264	483	625
Subtotal	**2,242**	**2,500**	**1,343**
Costs of new cases	1,367	1,009	825
Administrative fee	63	57	55
Total Workers' Compensation Expense	**$ 3,672**	**$ 3,566**	**$ 2,223**

For the year ended September 30, 2011, the Postal Service experienced a $118 million, or 18.4%, increase in compensation claim payments and a $21 million, or 4.7%, increase in medical claims payments compared to the year ended September 30, 2010. The increase in compensation payments for 2011 continues to be pronounced after a reassessment of employees on permanent rehabilitation or limited-duty status resulted in an increase in benefit payments to some beneficiaries.

In 2010, we began to use the average rate of medical inflation experienced by our workers' compensation claimants over the past five years as an estimate for future medical inflation. Prior to 2010, we had used forecasted medical inflation rates published by an independent source. During 2010, we determined that our own history served as a better indicator of future costs and revised our estimation accordingly. The impact of this change was to increase our liability by $50 million and was accounted for as a change in accounting estimate. For the year ended September 30, 2010, actual claim payments increased $48 million, or 4.6%, over 2009.

TRANSPORTATION EXPENSES

Transportation expenses are primarily for contracted air and highway transportation. Transportation expenses in 2011 were $6,389 million, an increase of $511 million, or 8.7%, compared to 2010. Compared to 2009, 2010 transportation expenses decreased $148 million, or 2.5%.

Transportation Expense

(Dollars in millions)	2011	2010	2009
Highway	$ 3,343	$ 3,205	$ 3,044
Air	2,110	1,977	2,014
International	886	641	856
Other	50	55	112
Total Transportation Expense	**$ 6,389**	**$ 5,878**	**$ 6,026**

HIGHWAY TRANSPORTATION

Highway transportation expenses in 2011 were $3,343 million, an increase of $138 million, or 4.3% from 2010. Even though fuel costs are only a portion of total highway transportation expense, they are the driver behind the increase in total transportation expense in 2011. Diesel fuel, which historically represents approximately 93% of all fuel purchased, cost an average of $3.66 per gallon during 2011, compared to $2.89 per gallon in 2010, an increase of 26.6%. Partially offsetting the increases in fuel costs in 2011 was an 88 million mile, or 5.4%, decrease in highway miles driven compared to 2010, as a result of national and local surface transportation utilization improvement initiatives.

Highway transportation expenses for 2010 were $3,205 million, an increase of $161 million, or 5.3%, from 2009. This increase was primarily the result of higher fuel prices and increased contractual miles driven. Diesel fuel cost an average of $2.89 per gallon in 2010, compared to $2.52 per gallon in 2009, a 14.7% increase. In addition to the higher fuel prices, contract adjustments and the implementation of our Network Distribution Centers (NDCs), which began in 2009, resulted in a temporary increase in contracted miles driven of 34.8 million miles, or 2.2%.

AIR TRANSPORTATION

Despite savings that continue to be captured due to the optimization of the air network and lower volume, sharply increasing jet fuel costs resulted in an increase in domestic air transportation expenses of $133 million, or 6.7%, to $2,110 million in 2011 from $1,977 million in 2010.

Air transportation expenses in 2010 decreased $37 million, or 1.8%, compared to 2009 expenses of $2,014 million. This was primarily due to lower mail volume and shifts from higher-cost air transportation to lower-cost highway transportation created by the 2009 NDC implementation.

INTERNATIONAL TRANSPORTATION

Expenses that are required to transport international mail include both the physical transportation of the mail and accruals of fees payable to foreign postal administrations for transportation of mail within their country. The largest component of international transportation expense, foreign postal transaction fees, represented 78%, 66% and 67% of the total international transportation expense in 2011, 2010, and 2009, respectively.

For 2011, international transportation expense of $886 million increased $245 million, or 38.2%, compared to last year as international foreign postal transaction rates increased, and as the ratio of packages to the less expensive First-Class Mail increased. Also in 2010, the Postal Service received a one-time benefit for the recapture of foreign postal payments required under Universal Postal Union regulation. There was no such benefit in 2011.

For 2010, international transportation expenses of $641 million decreased $215 million, or 25.1%, compared to 2009 as a result of lower volume, decreases in foreign postal transaction fees, and lower negotiated air carrier rates. In addition, 2010 was impacted by the previously mentioned one-time benefit for the recapture of payments discussed in the preceding paragraph.

OTHER TRANSPORTATION

Other transportation expenses for 2011 were $50 million, which was $5 million, or 9.1%, lower than 2010 expenses of $55 million.

Other transportation expenses for 2010 were $55 million, which was $57 million, or 50.9%, lower than 2009 expenses of $112 million. Lower rail transportation expense, which decreased $48 million, or 55.0%, drove this decrease, as we shifted business to other modes of transportation.

OTHER OPERATING EXPENSES

For 2011, other operating expenses of $9,822 million increased $496 million, or 5.3%, compared to 2010.

Other Operating Expenses

(Dollars in millions)	2011	2010	2009
Supplies and Services	$ 2,260	$ 2,236	$ 2,321
Depreciation and Amortization	2,313	2,469	2,270
Rent and Utilities	1,682	1,692	1,778
Vehicle Maintenance Service	974	820	760
Information Technology and Communications	695	664	722
Rural Carrier Equipment Maint. Allowance	554	534	510
Other	1,344	911	947
Total Other Operating Expenses	**$ 9,822**	**$ 9,326**	**$ 9,308**

Within total other operating expenses, other expenses increased $433 million, or 47.5% in 2011, driven by legal expenses associated with arbitration awards and the reassessment of contingent liabilities which increased expenses by $448 million in 2011. Vehicle maintenance service expense, including fuel costs used by the carrier fleet, increased by $154 million, or 18.8%, in 2011 from 2010, primarily as a result of the previously discussed increase in fuel costs during the year. Information technology and communications expense increased by $31 million, or 4.7%, in 2011 from 2010. Supplies and services increased by $24 million, or 1.1% from 2010. These increases were offset by decreases in depreciation and amortization of $156 million, or 6.3%, as compared to 2010. Rent and utilities was $10 million, or 0.6% lower in 2011 than 2010.

In 2010, other operating expenses increased by $18 million, or 0.2%, from the comparable 2009 amount. The increase was driven by depreciation and amortization expense, which increased by $199 million, or 8.8%, as a result of a reassessment of the useful lives of certain properties and the reclassification of certain leases from operating to capital leases. In addition, vehicle maintenance service expense, which includes the carrier fleet fuel costs, increased by $60 million, or 7.9%, primarily as a result of higher fuel costs in 2010 compared to 2009. Other expenses decreased by $36 million, or 3.8% in 2010 to $911 million as compared to 2009.

PRODUCTIVITY

Despite the many financial and operational challenges, in 2011 we were able to significantly increase operating efficiency.

Operating efficiency, as measured by Total Factor Productivity (TFP) increased 1.3% in 2011 as compared to 2010. This marks the tenth year of positive TFP growth since 2000 with cumulative TFP growth of 21.6% since 1972. Productivity gains are a result of effective workforce management, efficient use of material (supplies, services, and transportation), and maximizing the return on capital investments (mainly automation projects).

Work hours were reduced by 34 million, or 2.9%, in 2011 despite an increase of approximately 636,500 delivery points during the year. Non-personnel expenses increased by 6.6% while mail volume declined by 1.7%.

Work hour savings included approximately 9.4 million work hours in mail processing operations in 2011. This was accomplished primarily through processing plant consolidations and continued advancements in automation, mainly flats sequencing.

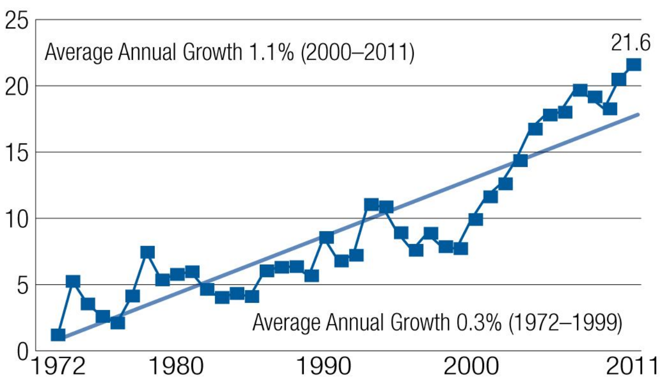
In 2010, the Postal Service consolidated carrier routes, eliminating over 1,100 routes, with an additional 6,461 routes eliminated in 2011. The net result of these actions helped drive a 9.2 million work hour reduction in city and rural delivery operations in 2011 and the disposal of over 1,700 postal-owned vehicles.

Declines in customer mail volume coupled with the increased electronic access to our services provided by alternate access channels such as Click-n-Ship, PC Postage, and Automated Postal Centers continue to reduce the requirement for customer service work hours. These efforts have improved customer access and convenience and made possible a 10.4 million work hour reduction in customer service operations.

Overall spending reductions in 2011 and 2010 also included decreases in capital expenditures of 15% and 24%, respectively.

The following graph shows the cumulative TFP trend from 1972 through 2011.

TFP Cumulative Trend, 1972–2011



LIQUIDITY AND CAPITAL RESOURCES

SUMMARY OF PROJECTED CASH SHORTFALL

The Postal Service continues to suffer from a severe lack of liquidity caused by over $25 billion of net losses over the past five years including $21 billion of expenses for prefunding retiree health benefits. We ended 2011 with $1.5 billion of total cash and $2.0 billion of remaining borrowing capacity on our $15 billion debt facility (see *Note 4- Debt* in the Notes to the Financial Statements). Our current financial projections indicate that we will not be able to make the required $5.5 billion prefunding payment for retiree health benefits currently due by November 18, 2011, or the required $5.6 billion prefunding payment for retiree health benefits that is due by September 30, 2012.

Additionally, even without the Postal Service making the $11.1 billion of scheduled PSRHBF payments in 2012, current projections indicate that we will have a precariously low level of cash and liquidity at September 30, 2012. As a result, we would likely not be able to meet all of our financial obligations by October 2012 when we are required to make a payment of approximately $1.3 billion to the Department of Labor (DOL) for workers' compensation.

MAJOR FACTORS LEADING TO PROJECTED CASH SHORTFALL

The Postal Service had net losses of $5,067 million, $8,505 million, and $3,794 million for the years ended September 30, 2011, 2010, and 2009, respectively. Cash flow from operations for these years was $494 million in 2011 and $1,573 million in 2009. Cash used by operations was $3,292 million in 2010. However, without the enactment of P.L. 111-68 in 2009, which reduced the required PSRHBF prefunding payment from $5.4 billion to $1.4 billion, and P.L. 112-33 in 2011, which changed the date the $5.5 billion prefunding payment is due, the last time that we would have had positive cash flow from operations would have been five years ago, in 2006.

Since 2006, we have made approximately $38 billion of prefunding payments to the PSRHBF. The $38 billion is comprised of $21 billion of cash from postal borrowings, and operations, plus $17 billion transferred from an overfunding of our CSRS account with OPM. In 2012, we are required to make $11.1 billion of prefunding payments: the $5.5 billion payment originally due by September 30, 2011, but deferred until not later than November 18, 2011, plus the previously scheduled $5.6 billion payment due by September 30, 2012. To date, no changes have been made to the $33.9 billion prepayment schedule for 2012 to 2016 required by P.L. 109-435.

As noted in previous filings, Postal Service losses for the past three years are attributable to a combination of the declines in mail volume that began in 2008, the statutory and regulatory provisions that have the effect of limiting our ability to reduce costs and increase revenue, and the statutory requirement to prefund retiree health benefits. The declines in mail volume are primarily a result of the economic recession that began in December 2007 and the protracted economic weakness that has followed, along with the acceleration of a long-term trend of hard-copy correspondence and transactions migrating to electronic media. Revenue in 2011 was $65.7 billion, a $1.3 billion, or 2.0%, decrease from 2010 and almost $2.4 billion less than 2009.

Since peaking at 213.1 billion pieces in 2006, mail volume has dropped 45.2 billion pieces, or 21.2%, to 167.9 billion pieces in 2011, including reductions of 26 billion pieces in 2009, 6 billion pieces in 2010, and 3 billion pieces in 2011. The decline in First-Class Mail volume, by 25 billion pieces or 25% during that five-year period, has had a particularly significant negative impact on the bottom line. To compensate for the loss of one piece of First-Class Mail, Standard Mail must increase by three pieces.

The volume that was lost to electronic alternatives, which was accelerated by the recession, is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses. Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the loss of First-Class Mail volume. In short, there currently is no foreseen revenue growth solution to our financial problem.

Forecasting in the current economic environment is subject to significant uncertainties. Our operational plan for 2012 anticipates a reduction in mail volume of approximately 8 billion pieces from 2011 levels with an associated drop in revenue of approximately $2 billion. Because of economic uncertainty and other currently unknown issues, it is possible that mail volume, and therefore revenue, could decrease at a rate greater than or less than this projection.

Compensation and benefits expenses represent approximately 65% to 71% of total operating expenses. However, when workers' compensation and retiree health benefits, including the legally mandated prefunding of the retiree health benefits, are added, total personnel expenses increase to approximately 77% to 80%. Although many significant steps have been taken to decrease compensation and benefits expenses in response to declining mail volume, many of these expenses remain fixed and beyond our control due to our participation in federal programs. Contracts with postal unions are negotiated for a fixed period of time, usually three to five years. They cannot be modified during the contract period except by mutual consent. Retirement benefits are not determined by management but rather by the federal government, and healthcare benefit costs mandated by law or contract continue to rise well above the rate of inflation. In addition, our ability to adjust our workforce and network infrastructure is limited by contractual, statutory, regulatory and political obstacles.

FUTURE CASH DEMANDS

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and total outstanding debt of $15 billion. As of September 30, 2011, total outstanding debt is $13 billion, leaving $2 billion of borrowing capacity for future needs.

As noted above, the total 2012 required prefunding payment for retiree health benefits to the PSRHBF is $11.1 billion: $5.5 billion due by November 18, 2011, and $5.6 billion due by September 30, 2012. In addition, we have a cash payment scheduled for October 2012 of approximately $1.3 billion to the DOL for the Postal Service's annual payment on its workers' compensation liability.

On June 24, 2011, as a result of the critically low liquidity level projected for the end of 2011 and all of 2012, we suspended our employer's contributions to OPM for the defined benefit portion of the FERS funding requirement. OPM has determined that the Postal Service had a FERS account surplus valued at approximately $6.9 billion as of September 30, 2009. OPM's latest calculation shows that the surplus has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made. We continue to transmit to OPM the employees' contributions to the FERS defined-benefit plan and also continue to transmit employer automatic and matching contributions and employee contributions to the Thrift Savings Plan.

The legally required Postal Service employer contribution to FERS is approximately $114 million per pay period (every two weeks). Suspension of payments, effective June 24, 2011, provided additional liquidity of $911 million through September 30, 2011. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer's contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011.

In order to avoid default, statutory or regulatory adjustments to some, or all, of these obligations are necessary. The legal and/or regulatory consequences to the Postal Service of a default on the required PSRHBF contributions or the workers' compensation payments to the U.S. Government, are unknown.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

We have taken numerous actions to generate additional revenue and reduce operating expenses. Some of these are discussed below.

We increased prices by an average of 1.7% for Mailing Services in April 2011 and by an average of 3.6% for Shipping Services in January 2011. The Mailing Services price increase was the first increase in almost two years. We announced a 2.1% average price increase for Mailing Services and expect to implement additional moderate price increases for Shipping Services, both of which are expected to become effective in January 2012. At the same time, efforts have been made to increase revenues by implementing initiatives such as the expansion of simplified addressing for businesses, Priority Mail Regional Rate Boxes, Reply Rides Free, Every Door Direct Mail, and others. However, these new services are not expected to offset the decline in volume and revenue that is occurring in First-Class Mail.

As a result of management cost-control initiatives, work hours for 2011 were reduced by 34 million hours compared to 2010. This is in addition to reductions of 75 million and 115 million in fiscal years 2010 and 2009, respectively.

A new labor contract with the APWU, which affects approximately 205,000 employees, became effective May 23, 2011. The contract, which expires May 20, 2015, establishes pay levels for new career employees that are approximately 10% lower than the existing pay schedule, provides increased workforce flexibility, and will allow for increased use of noncareer employees. Our contribution to employee health insurance premiums also will decrease. Provisions of the new agreement also include a 3.5% pay increase over the term of the contract, with no increases in 2011 and 2012. These pay increases are in addition to periodic cost-of-living-adjustments (COLAs), which are eliminated in 2011 and otherwise deferred until 2013.

To further reduce costs, we continue implementation of an organizational redesign to realign administrative functions by reducing the number of Area and District Offices, and decreasing the number of authorized administrative, supervisory, and Postmaster positions by approximately 7,500. We also suspended discretionary pay awards and have frozen officer and executive compensation. Additionally, the Postal Service continues to reduce the size of its workforce. Over the last five fiscal years, we have decreased our workforce by approximately 140,000 career positions and saved nearly $14 billion in total costs.

As noted in previous filings, we filed a request with the PRC on March 30, 2010, seeking an advisory opinion regarding the elimination of Congressionally mandated Saturday mail delivery to street addresses and associated changes. This is projected to save approximately $3 billion annually and remains a crucial component of the Postal Service's efforts to restructure operations. The PRC responded to this request on March 24, 2011, and indicated, among other things, that they believe that we would save $1.7 billion annually from the elimination of Saturday delivery according to their calculations. At approximately the same time, the Government Accountability Office (GAO) issued its own report, *Ending Saturday Delivery Would Reduce Costs, But Comprehensive Restructuring is Also Needed,* on March 29, 2011. The GAO's position was that "when fully implemented, 5-day delivery would provide USPS with needed cost savings, although the extent of those savings is uncertain" and that "USPS's 5-day proposal should be considered in the context of other restructuring strategies both within and outside the delivery network." We continue to pursue this matter.

In Quarter IV, 2011, we announced plans to rationalize our mail processing, delivery, and retail networks, along with revisions to service standards. These programs consist of a variety of initiatives, such as:

- Streamlining the network of mail processing facilities.
- Modifying delivery routes, apart from five-day delivery.

- Studying underutilized Post Office locations for potential consolidation, closure or conversion to a contract unit or a Village Post Office.
- Enhancing and expanding alternate access sites, including Village Post Offices and *http://www.usps.com*, and exploring franchising.
- Modifying service standards which will allow for longer operating windows and will reduce the requirements for equipment, facilities, and work hours.

These efforts are expected to help us to reduce labor and benefits costs. Current Postal Service projections anticipate a decrease of approximately 100,000 employees over the next three years, with potential annual savings of approximately $6.5 billion. The service standard changes related to these plans require that we request a non-binding advisory opinion from the PRC, which we expect to file in December 2011. The PRC is allotted a minimum of 90 days from the date of filing to render a non-binding opinion.

As previously noted, our ability to execute strategies to increase efficiency and reduce costs by adjusting our network, infrastructure, and workforce, and to retain and grow revenue, is currently constrained by contractual, statutory, regulatory, and political restrictions. As a result of these restrictions, our efforts to positively impact cash flow will not be sufficient, either individually or in the aggregate, to avoid a cash shortfall. Absent significant changes in the law, we will default on the $5.5 billion prepayment due to the PSRHBF by November 18, 2011, and on the $5.6 billion prepayment due by September 30, 2012. Additionally, even if legislative changes defer or eliminate the $11.1 billion of prefunding payments currently due to the PSRHBF in 2012, the $15 billion debt ceiling will likely be reached in October 2012, thereby exhausting our external funding ability.

POSTAL LEGISLATIVE REQUESTS

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF prefunding payment schedule and FERS overfunding, the Postal Service will continue to face financial stability concerns. We have taken, and continue to take, specific actions to address those elements under management's control. Despite these changes, the financial outlook continues to show the necessity of the following legislative changes, which we have already asked Congress to make:

- Resolve the retiree health benefits prefunding requirement which currently calls for $33.9 billion of additional prefunding payments from 2012 through 2016.
- Address the inequities in the current Civil Service Retirement System (CSRS) pension liability allocation methodology which has led to overfunding by the Postal Service by as much as $75 billion.
- Refund the FERS overfunding of $6.9 billion which according to OPM's latest calculation has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made.
- Grant the Postal Service the authority to determine delivery frequency.
- Allow the Postal Service to offer non-postal products and services.
- Allow the Postal Service to restructure its healthcare systems.
- Develop a more streamlined governance model for the Postal Service that would allow for quicker pricing and product development decisions than currently exists within the regulatory framework.

Due to the gravity of the financial situation, more than a half-dozen different postal reform-related bills have been introduced in Congress in the past year, in addition to a plan proposed by the Administration. These plans address some of the short- and long-term issues that we are facing.

There can be no assurance that any legislative changes will be made in time to impact 2012, or at all.

MITIGATING CIRCUMSTANCES

Our status as an independent establishment of the executive branch which does not accept tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. Despite falling mail volume, the Postal Service is still widely recognized as providing an essential service to the American economy, and there are a wide variety of potential legislative remedies that could resolve the short-term liquidity concerns. Therefore, it is unlikely that, in the event of a cash shortfall, the federal government would cause or allow us to significantly curtail or cease operations.

The Postal Service continues to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues the Postal Service faces and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2012, and beyond. However, there can be no assurances that the requested adjustments to the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

CAPITAL INVESTMENTS

At the beginning of 2011, there were fourteen major projects in progress (i.e., greater than $25 million), representing $3.7 billion in approved capital funding. During the year, two new projects were approved, which totaled $0.2 billion in additional capital funding. A total of five projects representing $0.8 billion in approved capital funding were completed. The year ended with eleven open projects that amount to $3.1 billion in approved capital.

While the funding for a project is authorized in one year, the commitment or contract to purchase or build may take place over several years. By year-end, approximately $2.7 billion had been committed to these eleven open projects. Actual capital cash outlays will occur over several years. Through the end of 2011, approximately $2.3 billion has been paid for the eleven projects.

As of September 30, 2011, all capital commitments (including the eleven projects mentioned above), consisting of building improvements, equipment and sustaining infrastructure investments, were $0.9 billion.

At the beginning of 2010, there were twenty major projects in progress, representing $4.5 billion in approved capital funding. During the year, three new projects were approved, which totaled $0.2 billion in additional capital funding. A total of nine projects representing $1.0 billion in approved capital funding were completed. The year ended with fourteen open projects in progress representing $3.7 billion in approved capital.

CASH FLOW

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operating activities was $494 million in 2011, compared to $3.3 billion used by operations in 2010, a year-to-year increase in cash provided by operations of $3.8 billion, driven by the deferral of a $5.5 billion decrease in the PSRHBF contribution caused by the deferral of the previously scheduled $5.5 billion PSRHBF prepayment from 2011 into 2012. Cash and cash equivalents at September 30, 2011, were $1.5 billion compared to $1.2 billion at the end of 2010. This increase was made possible due to the deferral of the required PSRHBF contribution from September 30, 2011, to due by November 18, 2011, as well as, the $911 million FERS employer contributions accrued but not yet paid at September 30, 2011.

Net cash used by operating activities was $3.3 billion in 2010, compared to $1.6 billion provided by operations in 2009. Net cash used by operating activities was $4.9 billion higher in 2010 versus 2009 primarily due to a $4.1 billion increase in the PSRHBF contribution and a $1.0 billion decrease in revenue. Cash and cash equivalents at September 30, 2010, were $1.2 billion compared to $4.1 billion at the end of 2009, due primarily to the $5.5 billion payment to the PSRHBF made in 2010 compared to the $1.4 billion payment in 2009.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used by investing activities in 2011 was $1.1 billion, compared to $1.3 billion in 2010. Purchases of property and equipment in 2011 of $1.2 billion decreased by $203 million from the prior year, and proceeds from building sales and the sale of property and equipment totaled $137 million in 2011, compared to $70 million in 2010.

Net cash used by investing activities was $1.3 billion in 2010, compared to $1.8 billion used in 2009. Purchases of property and equipment of $1.4 billion decreased by $446 million in 2010 from the $1.8 billion purchased in 2009. Proceeds from building sales and the sale of property and equipment totaled $70 million in 2010, compared to $33 million in 2009.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash provided by financing activities was $0.9 billion in 2011 and $1.7 billion in 2010. Debt with the Federal Financing Bank (FFB) increased by $1.0 billion in 2011 and by $1.8 billion in 2010.

The following table summarizes the cash requirements of contractual obligations as of September 30, 2011.

Contractual Obligations		**Payments Due by Year**			
(Dollars in millions)	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**After 5 Years**
Debt (1)	$ 13,000	$ 7,500	$ 300	$ 300	$ 4,900
Interest on debt (1)	2,242	179	344	336	1,383
PSRHBF	33,900	11,100	11,300	11,500	0
Capital lease obligations	752	103	187	175	287
Operating leases	7,301	739	1,334	1,089	4,139
Capital commitment (2)	881	507	284	60	30
Purchase obligations (2)	2,840	1,449	1,390	2	-
Workers' compensation (3)	20,289	1,242	3,898	2,981	12,168
Employees' leave (4)	2,220	247	248	272	1,453
Total Contractual Obligations	**$ 83,425**	**$ 23,066**	**$ 19,285**	**$ 16,715**	**$ 24,360**

(1) For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.
(2) Legally binding obligations to purchase goods or services. Capital commitments pertain to purchases of equipment, building improvements and vehicles. Purchase obligations generally pertain to items that are expensed when received or amortized over a short period of time. Capital commitments and purchase obligations are not reflected on the Balance Sheet.
(3) Assuming no new cases in future years. This amount represents the undiscounted expected workers' compensation payments.The discounted amount of $15,142 million is reflected in our Balance Sheet at September 30, 2011.
(4) Employees' leave includes annual and holiday leave.

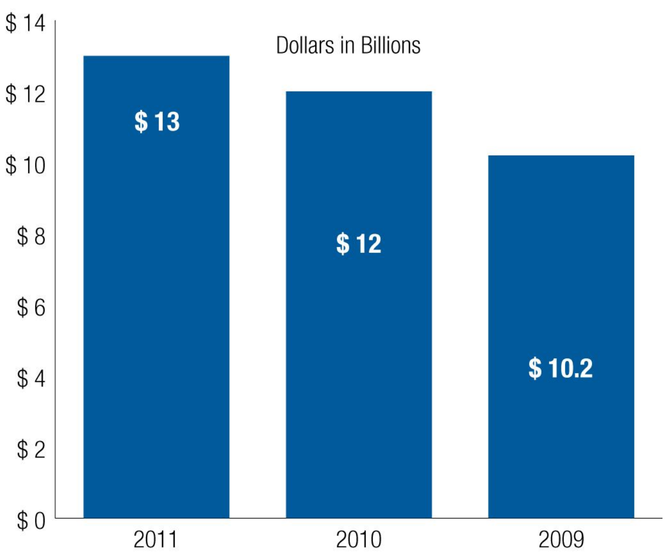
FINANCING ACTIVITIES

DEBT

As an "independent establishment of the executive branch of the Government of the United States," the Postal Service receives no tax dollars for ongoing operations, and has not received an appropriation for operational costs since 1982. We fund operations chiefly through cash generated from operations and by borrowing from the FFB.

The amount borrowed is largely determined by three major factors: (1) the difference between cash flow from operations (which in 2010 and 2009 included prefunding payments to the PSRHBF of $5.5 billion and $1.4 billion, respectively); (2) capital cash outlays, which include funds invested for new facilities, new automation equipment, and new services; and (3) annual borrowings, which are limited by statute to $3 billion. An additional determinant is our statutory debt ceiling of $15 billion. On September 30, 2011, there was $13.0 billion in debt outstanding, a $1.0 billion increase from September 30, 2010.

Debt at Year End



INTEREST EXPENSE

In 2011, interest expense was $172 million, an increase of $16 million, or 10.3%, compared to 2010. Net losses for the three years ended September 30, 2011, have resulted in higher debt levels. Although long-term debt carries higher interest rates than prevailing rates for short-term debt, long-term obligations were issued in 2009 and 2011 with favorable rates as compared with prior periods. Financing a portion of debt at fixed rates decreases our interest rate risk and interest expense volatility in future years. At September 30, 2011, $5.5 billion of these long-term obligations remain outstanding. The increasing debt levels have led to higher interest expense in 2011 versus prior years. However, short-term interest rates remained at historically low levels helping to keep total interest expense relatively low. In 2010 and 2009, with less debt outstanding throughout the year, interest expense totaled $156 million and $80 million, respectively.

INTEREST AND INVESTMENT INCOME

When we determine that available funds exceed current needs, funds are invested with the U.S. Treasury's Bureau of Public Debt in overnight securities issued by the U.S. Treasury.

Interest and Investment Income

(Dollars in millions)	2011	2010	2009
Imputed Interest - Revenue Forgone	24	24	24
Other Interest	4	1	2
Total Interest and Investment Income	**$ 28**	**$ 25**	**$ 26**

We also recognize imputed interest on the funds owed to us under the *Revenue Forgone Reform Act of 1993*. Under the Act, Congress agreed to reimburse the Postal Service $29 million annually through 2035 for services performed in prior years. See Note 11, *Revenue Forgone*, in the Notes to the Financial Statements for additional information.

LEGAL MATTERS AND CONTINGENT LIABILITIES

An estimated loss contingency is accrued in our financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Assessing contingencies is highly subjective and requires judgments about future events. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual loss may differ significantly from these estimates. In 2011, the material claim outstanding is the following:

McConnell v. Potter: On January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Potter, with the class consisting of all permanent rehabilitation employees and limited-duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to the present. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet-unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter. See Note 6, *Contingent Liabilities*, in the Notes to the Financial Statements for additional information.

FAIR VALUE MEASUREMENTS

In 2011 and 2010, our financial statements contain fair value disclosures required by GAAP. We did not have any recognized gains as a result of these valuation measurements in these years. All recognized losses have been incorporated into our financial statements, and the unrecognized gains and losses are not considered to have a significant impact upon our operations. See Note 10, *Fair Value Measurement*, in the Notes to the Financial Statements for additional information.

LEGISLATIVE UPDATE

Appropriations and Continuing Resolutions

On October 5, 2011, the President signed into law P.L 112-36, the *Continuing Appropriations Act*, 2012, which funds the government through November 18, 2011. This law provides for a deferment of the PSRHBF prefunding payment of $5.5 billion due by October 4, 2011, to not later than November 18, 2011. This is the second deferment of the prepayment, which was originally due by September 30, 2011.

We believe passage of P.L. 112-36, is intended to provide time for lawmakers to agree on potential postal reform legislation, although there is no assurance that such complex legislation will be enacted by November 18, 2011, or at all. The continuing resolution also carries forward existing provisions that keep in place six-day delivery requirements, as well as prohibitions on closing small and rural Post Offices solely for financial reasons.

On September 30, 2011, the President signed into law P.L. 112-33, the *Continuing Appropriations Act*, 2012, which funded the government through October 4, 2011. This law provided for the initial deferment of the PSRHBF prefunding payment to be due by October 4, 2011.

On September 15, 2011, the Senate Committee on Appropriations reported an original measure, S. 1573, the Financial Services and General Government Appropriations Act, 2012. This action followed the July 7, 2011, reporting of H.R. 2434, the House Committee on Appropriations measure H.R. 2434, the Financial Services and General Government Appropriations Act, 2012. Both the Senate and House versions recommend a funding level of $78 million to the Postal Service, for free mail for the blind and overseas voting. This amount is $8.5 million less than the amount provided in FY 2011 and is less than the amount requested by the Postal Service. Additionally, the bill did not appropriate any funds for the $29 million revenue forgone debt repayment. Both bills also carry forward provisions that call for maintaining six-day delivery, as well as prohibitions against closing small or rural Post Offices solely for financial reasons.

On March 3, 2011, S. 475, the Enacting President Obama's Recommendations for Program Termination Act was introduced. The measure provides for the repeal of the authorization and funding for a total of 85 programs; specifically, programs identified in the President's Budget Request for FY 2012. S. 475 includes a provision stating that no federal funds are to be expended for the revenue forgone from the reduced rate mail program of the Postal Service. It directs that any funds appropriated to or unobligated by the program be rescinded and returned to the Treasury. The bill was referred to the Senate Appropriations Committee.

Administration Proposals

Presidential Postal Reform Proposals

On September 19, 2011, the Office of Management and Budget (OMB) released a report entitled, "Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction." Included in the White House plan, which is part of a larger effort to cut $3 trillion from the federal deficit, are several proposals focused on improving the financial situation of the Postal Service. The plan recognizes the importance and value of the Postal Service to the nation's overall economy and presents a reform package that calls for: restructuring the existing retiree health benefits prefunding to move payments to an accrual cost basis; providing the Postal Service with a refund, over two years, of the $6.9 billion surplus in the Federal Employees Retirement System (FERS) as of September 30, 2009; giving the Postal Service the authority to move to a five-day per week delivery, beginning in 2013; allowing the Postal Service the flexibility to offer non-postal products and services and to increase partnerships with state and local governments; and permitting the Postal Service to pursue a modest one-time increase in prices, while continuing to operate under the current price cap. The Administration estimates the proposals would provide the Postal Service with over $20 billion in cash relief over the next several years and in total would reduce the federal deficit by $19 billion over 10 years.

Joint Select Committee on Deficit Reduction

The President's postal reform proposals were submitted to the Joint Select Committee on Deficit Reduction (also known as the "Super Committee"); a panel created by the Budget Control Act of 2011 and charged with issuing formal recommendations on how to reduce the deficit by at least $1.5 trillion over the next ten years.

The Joint Select Committee is comprised of six Democrats and six Republicans. There are three members of each party from the Senate, and three members of each party from the House. The deadline for the Super Committee to make its recommendations to Congress is November 23, 2011. Congress will then have until December 23, 2011, to give the recommendations an up-or-down vote, with no amendments permitted.

On October 13, 2011, Democratic leaders from 16 House committees released their deficit reduction recommendations to the Super Committee. Several of the recommendations would affect the Postal Service. One recommendation is to amend the Statutory Pay-As-You-Go Act of 2010 to evaluate Postal Service legislation on a unified budget basis, so that both on-budget and off-budget effects are counted together. Other recommendations are to restructure the PSRHBF prefunding schedule and to refund the Postal Service's accumulated FERS surplus of approximately $6.9 billion as of September 30, 2009. The leaders recommended replacing the current PSRHBF prefunding schedule with a more realistic longer-term prefunding schedule.

On October 14, 2011, Rep. Darrell Issa (R-CA), Chairman of the House Committee on Oversight and Government Reform, released his recommendations to the Super Committee. In a section of his letter on the Postal Service, he recommended the Joint Select Committee not include postal reform in its proposals, which are due to Congress in November. Chairman Issa stated he did not believe postal reforms will reduce the deficit and that the House and Senate Oversight Committees were already working on postal reform efforts.

Also on October 14, 2011, Senators Joseph Lieberman (I-CT), Chairman, and Susan Collins (R-ME), Ranking Member of the Senate Homeland Security and Governmental Affairs Committee, released their recommendations to the Super Committee. In a section of their letter on the Postal Service, they indicated that their committee was developing postal reform legislation to align postal costs and revenues, and to ensure that essential mail service is maintained. Once developed, this proposed legislation would be shared with the Joint Select Committee.

PRESIDENT'S BUDGET REQUEST FOR FY 2012

On February 14, 2011, the President unveiled his FY 2012 Budget Request, which contained several proposals that would affect the Postal Service. It would have reduced the PSRHBF prefunding payment, due by September 30, 2011, by $4 billion, and it would also have provided an amortization schedule to pay down the remaining unfunded liability over time. It would also amend current law to allow the Office of Personnel Management (OPM) to return the then-estimated $6.9 billion surplus in the Postal Service's FERS account, with the Postal Service paid back over 30 years, including an estimated $550 million paid in 2011.

The President's budget proposal would delete provisions of the Revenue Forgone Reform Act of 1993, which authorizes the Postal Service to receive $29 million annually through 2035 to reimburse the Postal Service for services provided from FY 1991 through FY 1998, thereby reducing future cash flow of over $700 million. The President's budget proposal outlined three key principles to help secure the Postal Service's future, including: a realignment of the Postal Service's infrastructure, facilities, processing and delivery systems to continuously improve efficiency; promote an adaptive 21st Century workforce; accelerate value creation and enhance service to the public while respecting fair competition in the marketplace.

Congressional Postal Reform Proposals

The 112th Congress has introduced a number of bills that could affect the Postal Service. The following is a detailed description of four major reform bills and their current status. Also included is a list of other postal-related legislation introduced this year.

The 21st Century Postal Service Act of 2011

On November 2, 2011, S. 1789, the 21st Century Postal Service Act of 2011 was introduced. S. 1789 contains provisions covering a number of issues, including a requirement for OPM to return a FERS surplus to the Postal Service for each year a surplus is calculated, with some portion of the surplus used for retirement incentives. The bill provides for a restructuring of the existing prepayment schedule for PSRHBF; and proposes government-wide workers' compensation reforms.

The Postal Service would be prohibited from instituting five-day delivery for a two-year period following enactment of S. 1789, but could be allowed after a GAO report on the financial necessity of five-day delivery and a second PRC advisory opinion. Other provisions include: requiring an arbitrator to consider the financial condition of the Postal Service when making decisions on collective bargaining agreements; creating service standards for retail access; consolidating of door delivery points to curbside, sidewalk or centralized delivery; permitting the Postal Service to offer new non-postal services; and allowing for the mailing of wine and beer.

On Nov. 9, 2011, S. 1789 was marked up by the full Senate Committee on Homeland Security and Governmental Affairs. During the markup, a total of ten amendments were offered. Six amendments passed and four were defeated. Two amendments changed the original bill, including one striking the section requiring Medicare eligible postal retirees to enroll in Medicare parts A and B, and which would have substituted their current Federal Employee Health Benefits (FEHB) insurance for a to-be-negotiated “Medigap” style plan. A second successful amendment would require additional steps be added to the existing process for consolidating or closing Post Offices.

POSTAL REFORM ACT OF 2011 (HOUSE)

On June 23, 2011, H.R. 2309, the Postal Reform Act of 2011 was introduced in the House of Representatives. The bill would create a Commission on Postal Reorganization (CPR), which would conduct proceedings regarding closures and discontinuances of the Postal Service infrastructure, including retail facilities, mail processing facilities, and area and district offices. The bill provides the Postal Service with the authority to change delivery frequency. It also establishes a Postal Service Financial Responsibility and Management Assistance Authority, which would operate during any control period. A control period commences whenever the Postal Service has been in default to the U.S. Treasury, with respect to borrowing, for a period of 30 days. The Authority would have broad powers during such control period, including assuming all of the powers of the Postal Service Board of Governors. Other issues addressed in H.R. 2309 include: modifying collective bargaining agreements; placing limitations on Postal Service contributions to life and health insurance programs under FEGLI and FEHBP; modifying some postal rates, allowing the Postal Service to offer specific non-postal products and services; and making reforms in specific Postal Service contracting practices and provisions.

On October 13, 2011, H.R. 2309 was marked up by the full House Committee on Oversight and Government Reform. During the markup, a total of 24 amendments were offered. Fourteen amendments passed, eight were defeated, and two were withdrawn. The Committee voted to report H.R. 2309, as amended, favorably to the House by a margin of 22–18. The bill now moves to the full House for consideration.

POSTAL OPERATIONS SUSTAINMENT AND TRANSFORMATION (POST) ACT OF 2011

On May 17, 2011, S. 1010, the Postal Operations Sustainment and Transformation (POST) Act of 2011 was introduced. The POST Act addresses crucial legacy cost issues, such as retiree health benefits prepayments and overpayments to the Civil Service Retirement System (CSRS) and the Federal Employees’ Retirement System (FERS). It requires the Office of Personnel Management (OPM) to use a new methodology to value the Postal Service’s CSRS obligation, as well as determine whether a surplus exists in the FERS. The measure provides for various actions that determine use of any surplus, including using it to pay for retiree health benefit obligations, pay down the debt, or make payments related to workers’ compensation, pending Board approval. S. 1010 also removes the prohibition against closing a Post Office solely for economic reasons and gives the Postal Service delivery flexibility. It requires an arbitrator to consider the financial health of the Postal Service when rendering final decisions on collective bargaining. It provides flexibility for the development and introduction of non-postal products and services, allows for the shipment of wine and beer, and permits the Postal Service to partner with federal, state and local agencies. S. 1010 was referred to the Senate Committee on Homeland Security and Governmental Affairs.

U.S. POSTAL SERVICE IMPROVEMENTS ACT OF 2011

On February 15, 2011, S. 353, the U.S. Postal Service Improvements Act of 2011 was introduced. The measure directs the OPM to modify its methodology for calculating the Postal Service’s payments into both the CSRS and the FERS funds, and allows the Postal Service to transfer any surplus from those funds into the PSRHBF or to apply existing surpluses to workers’ compensation liability payments or to pay down its existing debt. The bill also requires an arbitrator to consider the Postal Service’s financial health when rendering decisions about collective bargaining agreements; and includes various other business rules. Finally, it would also convert federal and postal employees on workers’ compensation to retirement upon the employee’s reaching retirement age, if workers’ compensation benefits would exceed retirement benefits. The bill was referred to the Senate Homeland Security and Governmental Affairs committee.

FEDERAL EMPLOYEES' COMPENSATION REFORM ACT OF 2011

On February 2, 2011, S. 261, the Federal Employees' Compensation Reform Act of 2011, was introduced. The bill would apply to all Federal and Postal employees currently covered by the Federal Employees’ Compensation Act (FECA). S. 261 would require employees receiving FECA benefits to transition to the applicable retirement system when the recipient reaches retirement age. The bill was referred to the Homeland Security and Governmental Affairs Committee.

OTHER POSTAL RELATED LEGISLATION

S. 1688, the Save Our Postal Worker Jobs Act of 2011, introduced on October 12, 2011. S. 1688 would amend the provisions of Title 5, U.S.C., relating to the methodology for calculating the amount of any Postal surplus or supplemental liability under the CSRS.

H.R. 3174, the USPS Pension Obligation Recalculation and Restoration Act of 2011, introduced on October 12,

2011. Amends the provisions of Title 5, U.S.C., relating to the methodology of calculating the amount of any postal surplus or supplemental liability under the CSRS; also directs that the USPS cannot close a Post Office unless another postal facility is located within 10 miles.

S. 1649, the United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011, introduced on October 4, 2011. Addresses possible surplus in CSRS for the Postal Service, directs treatment of any surplus, and directs that the USPS may not close any Post Office which is located more than 10 miles from any other Post Office.

S. 1625, the Postal Reform Act of 2011, introduced on September 23, 2011. Establishes "Authority" to oversee USPS in the event of default; creates BRAC-like commission for Post Office closings; similar to H.R. 2309, except for increase in borrowing authority.

H.R. 2967, the Innovate to Deliver Act of 2011, introduced on September 15, 2011. Addresses a range of issues, including innovation, operational flexibility, workforce realignment and regulatory relief.

H.R. 2956, the Fair and Equitable Postal Service Access Act, introduced on September 15, 2011. Amends Title 39, to provide for additional criteria for the USPS to consider with respect to closing or consolidating a post office.

H.R. 2884, the USPS Retiree Health Benefits Prepayment Extension Act of 2011, introduced on September 12, 2011. Extends the current deadline for payment to the PSRHBF, until December 31, 2011.

H.R. 2692, the Access to Postal Services Act, introduced on July 28, 2011. Modifies procedures governing the closure or consolidation of postal facilities.

H.R. 2465, the Federal Workers' Compensation Modernization and Improvement Act, introduced on July 8, 2011. Would amend the Federal Employees' Compensation Act (FECA).

H.R. 2024, the Post Office Transparency Act, introduced on May 26, 2011. Amends Title 39 to apply the same procedures for closing/consolidating a postal station or branch, as those used for a Post Office.

H.R. 1351, the United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011, introduced on April 4, 2011. Amends Title 5 to address CSRS pension obligation surplus and treatment of any surplus, as well as addressing FERS surplus.

H.R. 1262, the Reform the Postal Service for the 21st Century Act, introduced on March 30, 2011. Seeks to reform the United States Postal Service in order to fulfill its constitutional mandate, to improve its efficiency, to help it meet its universal service obligation and to facilitate private sector economic growth.

OUTLOOK

The financial outlook for 2012 and beyond remains clouded by a weak economy, continuing uncertainty regarding the insupportably large PSRHBF prefunding contributions required in 2012 and future years, and the continuing need for structural reforms that can only be accomplished through legislative action. These, and other challenges, are discussed below.

Historically, the financial outlook for the Postal Service has been closely linked to the outlook for the U.S. economy and changes in the use of the mail. In the past three years, the American economy experienced its worst economic downturn since the Great Depression and mail volume fell precipitously. The recovery from the recession has been slow, weak, and uneven; lingering high unemployment, a weak housing market and low-levels of consumer confidence remain a major concern. During the summer, economic growth slowed further, fueling fears of a double-dip recession. Although growth in the third quarter of calendar 2011 has proved to be weaker than expected, it is expected that growth in the fourth quarter will be stronger, if only by 1%.

It is estimated that GDP growth will be less than 2.0% in 2012. Consumer spending, which accounts for approximately 70% percent of the U.S. economy is estimated to grow only 2.7% in 2012 due to lackluster employment growth. Business investment is expected to grow modestly; however, this would mark a second consecutive year of slowing growth. The consumer spending and estimated business investment trends do not provide the growth stimulus necessary to grow mail volumes in 2012.

In the longer term, the economy is expected to continue to grow at rates well below those of the late 1990s and early 2000s. When considered in light of the continued diversion of hard-copy mail, particularly First-Class Mail, to electronic media, the long-term trend of mail volume and revenue is likely to be downward.

REVENUE OUTLOOK

For 2012, we project revenue to decline for the fourth consecutive year. Revenue will see a small boost from Shipping Services but this will be more than offset by First-Class Mail declines.

First-Class Mail volume is expected to decline during 2012 for the seventh straight year. First-Class single-piece letters have been in decline for more than a decade and are expected to continue to decline in both the short- and long-term.

Standard Mail volume has fallen by approximately 18% since peaking in 2007. For 2012, Standard Mail revenue is expected to remain flat and volume is expected to decline.

Periodicals volume and revenue are also projected to decrease in 2012, which represents the continuation of a long-term trend.

Shipping Services are the bright spot in the 2012 outlook, as volumes and revenues are expected to increase. This entire group is influenced by competitors' prices, which often include fuel surcharges, and by our own advertising and promotional initiatives. Unfortunately, Shipping Services, by themselves, do not represent a sufficiently large portion of our business to offset revenue declines in other areas.

EXPENSE OUTLOOK

Total expenses for 2012, excluding retiree health benefits, are expected to decrease by $900 million, as we prepare to begin the most aggressive cost-reduction program in the history of the Postal Service. The Network Optimization initiative, when completed, is expected to reduce the number of mail processing locations by nearly 250. As part of this initiative, we are proposing a substantially nationwide relaxation of market-dominant service standards, which requires that we request a nonbinding advisory opinion from the PRC. We expect to file a request for a nonbinding advisory opinion in December 2011. We hope to begin consolidations of facilities and transportation routes in spring 2012. This initiative has the potential to reduce employee complement by up to 35,000 positions. We are projecting up to $3 billion in cost savings from this initiative, with the majority of the savings occurring in 2013 and 2014.

In addition, we are studying 3,600 low-activity Post Offices for possible closure or consolidation. Delivery-route optimization initiatives, initiated in 2011, will continue in 2012. Overall, in 2012, we are projecting that we will use over 50 million fewer work hours than in 2011.

A continuing challenge that must be overcome in order to achieve these work-hour savings targets will be our ability to reduce employee complement rapidly enough to fully capture the savings opportunities generated by these initiatives. Our contracts with our labor unions greatly restrict our ability to use layoffs and reductions in force (RIFs) to right-size our labor force. Because we lack the ability to utilize the RIF provisions generally applicable to the federal competitive service, and our layoff authority is constrained by collective bargaining agreements, our ability to reduce the workforce is largely limited to relying on attrition, reassigning employees to other facilities and crafts, and offering incentives to leave the organization. The limitations on our labor flexibility adversely affect our ability to immediately achieve cost savings and financial solvency.

Two overriding issues affecting our financial projections for 2012 and beyond are the retiree health benefits prefunding payments and the FERS overfunding. Under current law, we are required to contribute $11.1 billion to the PSRHBF in 2012 to prefund retiree health benefits, a funding obligation that is simply impossible for us to meet. We have determined that the Postal Service would be best able to meet its obligation to provide health benefits to its retirees and fulfill the prefunding mandate of P.L. 109-435 by sponsoring a separate Postal Service health plan in which retiree benefits would be fully integrated with Medicare. We have requested that Congress grant us the authority to establish such a long-term plan.

Likewise, the ability to immediately access our FERS surplus, which has accumulated over many years, is an essential underpinning to our short-term financial solvency. We need a full refund of this overpayment to ensure that we will have sufficient liquidity to fund operations (excluding PSRHBF prefunding) beyond year-end 2012.

Despite the fact that we have currently overfunded our obligation to the FERS retirement program, in 2012 the Postal Service will be required to increase the employer's share of contributions for employees under FERS to 11.9%. This will add approximately $50 million to 2012 compensation and benefit expenses.

In addition, we are currently negotiating new contracts with the NALC and NPMHU because current agreements expire on November 20, 2011. Contract negotiations with the NRLCA have reached an impasse and have moved to arbitration. Arbitration hearings are scheduled to begin December 5, 2011. The financial impact of the new labor contracts cannot be determined at this time.

We have also requested from Congress the authority to determine the number of delivery days that are necessary to fulfill our universal service mandate. Eliminating Saturday delivery presents the opportunity to achieve an additional $3 billion in annual savings, beginning the first year after full implementation.

It should be noted that the outlook for non-cash expenses for workers' compensation cannot be predicted because these changes are largely dependent on the level of interest rates. A 1% increase or decrease in interest rates could decrease or increase workers' compensation expense by over $1 billion.

In summary, economic, legislative, and regulatory developments in 2012 will have a great impact on the short- and long-term financial outlook for the Postal Service. The net impact of these developments may exceed those of the initiatives over which management has complete control.

ITEM 7A — QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK DISCLOSURE

In the normal course of business, we are exposed to market risk from changes in commodity prices, certain foreign currency exchange rate fluctuations, and interest rates. We do not use derivative financial instruments to manage market risks. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

FUEL COST RISK

As of September 30, 2011, we estimate that a 1% increase in fuel and natural gas costs would result in a $26 million increase in expense. We do not use derivative commodity instruments to manage the risk of changes in energy prices during the periods covered by this report.

FOREIGN EXCHANGE RISK

We are exposed to market risk arising from changes in currency exchange rates as a result of operations outside the United States. Currency exchange rate fluctuations may favorably or unfavorably impact reported earnings.

We estimate that a 1% increase or decrease in foreign exchange rates would have an insignificant impact on our financial statement due to the small percentage of our receipts and disbursements denominated in foreign currencies.

INTEREST RATE RISK

We have not used derivative financial instruments to manage risk related to interest rate fluctuations for debt instruments. However, we did issue long-term, fixed-rate debt in 2009 and again in 2011 that will mitigate exposure to rising interest rates in future years. We estimate that a 1.0% increase in interest rates would result in a $58 million increase in interest expense.

In addition, the valuation of our workers' compensation liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the interest rates assumptions would decrease the September 30, 2011, liability and 2011 expense by approximately $1.5 billion. A decrease of 1% would increase the September 30, 2011, liability and 2011 expense by approximately $1.9 billion.

LABOR CONTRACTS

As discussed in Item 1A, Risk Factors, the contracts with our four largest unions historically have included provisions granting COLAs linked to changes in the CPI-W. The new APWU contract ratified in 2011 had no COLA for 2011 and defers all other COLAs until 2013. As of the date of this report, the contracts with NPMHU and NALC are due to expire on November 20, 2011. New contracts are under negotiation. The NRLCA contract is in arbitration and hearings are scheduled to begin on December 5, 2011.

ITEM 8 — FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our audited Statements of Operations, Balance Sheets, Statements of Changes in Net Deficiency, and Statements of Cash Flows are included in Item 15 of this report.

ITEM 9 — CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A — CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in quarterly and annual reports is recorded, processed, summarized, and reported within the time frames specified by P.L. 109-435, and that this information is accumulated and communicated to management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of September 30, 2011. Based upon and as of the date of the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in the Postal Service's internal controls over financial reporting during the quarter ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate controls over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that, in reasonable detail, accurately and fairly reflect our transactions, providing reasonable assurance that transactions are recorded as necessary for the preparation of our financial statements, providing reasonable assurance that receipts and expenditures of assets are made in accordance with management authorization and providing reasonable assurance that unauthorized acquisition, use or disposition of assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of September 30, 2011.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The effectiveness of our internal control over financial reporting as of September 30, 2011, has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited our financial statements included in this Annual Report on Form 10-K. Ernst & Young LLP's report on our internal control over financial reporting is included in this Annual Report on Form 10-K on Page 61.

ITEM 9B — OTHER INFORMATION

None.

Part III

ITEM 10 – DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

THE POSTAL SERVICE IS GOVERNED BY AN ELEVEN MEMBER BOARD OF GOVERNORS.

The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the United States Senate, plus the Postmaster General and the Deputy Postmaster General. The seven currently appointed Governors are:

Name, Age, and Term of Office	Positions and Experience
Louis J. Giuliano, Chairman of the Board of Governors, Age 64	Chairman of the Board of Governors since January 2010. Vice Chairman of the Board of Governors, February 2009 to January 2010. Chairman, Operations Subcommittee, and member, Compensation and Management Resources Committee. Former Chairman of Board of Directors, President and Chief Executive Officer of ITT Corp. Senior Advisor at the Carlyle Group. Formerly a director of The ServiceMaster Company.
Governor since November 2004. Term expiring December 2014.	
Thurgood Marshall, Jr. Vice Chairman of the Board of Governors, Age 55	Vice Chairman of the Board of Governors since January 2010. Chairman, Government Relations and Regulatory Committee, and member, Audit and Finance Committee. Partner since 2006 at the law firm of Bingham McCutchen and principal with Bingham Consulting Group since 2006. Formerly served President Clinton as Assistant to the President and Cabinet Secretary. Former Director of Legislative Affairs and Deputy Counsel for Vice President Gore. Director, Corrections Corporation of America.
Governor since December 2006. Term expiring December 2011.	
Mickey D. Barnett, Governor, Age 60	Member of Compensation and Management Resources Committee, and member, Audit and Finance Committee. Attorney in Albuquerque, New Mexico. Former member, New Mexico State Senate. Former member, Appellate Nominating Commission for the New Mexico Supreme Court of Appeals. Former Legislative Assistant to Senator Pete Domenici of New Mexico.
Governor since August 2006. Term expiring December 2013.	
James H. Bilbray, Governor, Age 73	Member of Governance and Strategic Planning Committee, and member, Government Relations and Regulatory Committee. Attorney at the law firm of Kaempfer Crowell Renshaw Gronauer & Fiorentino in Las Vegas, Nevada. Former member, U.S. House of Representatives from Nevada. Former member, Nevada State Senate. Former Deputy District Attorney in Clark County, Nevada. Member of 2005 Base Realignment and Closing Commission.
Governor since August 2006. Term expiring December 2015.	

Name, Age, and Term of Office	Positions and Experience
James C. Miller III, Governor, Age 69	Past Chairman of the Board of Governors, 2005 through 2008. Chairman, Audit and Finance Committee, and a member of the Governance and Strategic Planning Committee. Senior Advisor at the international law firm of Husch Blackwell LLP since 2006. Senior Fellow (by courtesy) of the Hoover Institution at Stanford University since 1988 and Senior Fellow of the Center for Study of Public Choice at George Mason University since 1988. Member of Boards of Washington Mutual Investors Fund, American Funds Tax-Exempt Series I, the JP Morgan Value Opportunities Fund and Clean Energy Fuels Corp. Former Director, United States Office of Management and Budget and Member of National Security Council from 1985 to 1988. Former Chairman, United States Federal Trade Commission from 1981 to 1985. Formerly a director of FLYi, Inc. (operator of Independence Air).
Governor since April 2003. Term expired December 2010, but continues to serve hold-over year which expires December 2011.	
Dennis J. Toner, Governor, Age 60	Member of the Compensation and Management Resources Committee and a member of the Operations Subcommittee. Founder and principal since 2006 of Horizon Advisors, a private consulting business which provides guidance and strategic planning to private clients and non-profit organizations and maintains a professional resource network intended to advise and promote dialogue among the public, private and non-profit sectors. Deputy Chief of Staff, to then-Senator and now-Vice President Joseph Biden, Jr., 1995 to 2005.
Governor since October 2010. Term expiring December 2012.	
Ellen C. Williams, Governor, Age 54	Chairman of the Compensation and Management Resources Committee and a member of the Government Relations and Regulatory Committee. Owner and CEO of Capital Network, a government affairs and lobbying firm, since its establishment in 2006. Former Vice Chairman of the Kentucky Public Service Commission from 2004 to 2005. Former Commissioner of the Governor's Office for Local Development in Kentucky from 2005 to 2006. Former Chairman of the Republican Party of Kentucky from 1999 to 2004. Former executive assistant to Senator Bob Kasten.
Governor since August 2006. Term expiring December 2014.	

THE POSTAL SERVICE BOARD OF GOVERNORS HAS AN AUDIT AND FINANCE COMMITTEE.

The Audit and Finance Committee has three Governors, as follows: Governor Miller, Chairman, Governor Barnett, and Governor Marshall. The Board of Governors has determined that Governor Miller qualifies as an audit committee financial expert as defined by the rules of the SEC. All Audit and Finance Committee members are independent as defined by the rules of the SEC.

THE POSTAL SERVICE BOARD OF GOVERNORS HAS A COMPENSATION AND MANAGEMENT RESOURCES COMMITTEE.

The Compensation and Management Resources Committee composed of Chairman Williams, Governor Barnett, Governor Giuliano and Governor Toner during fiscal year 2011, was responsible for making recommendations to the Governors with respect to compensation decisions.

AT SEPTEMBER 30, 2011, THE POSTAL SERVICE HAD EIGHT EXECUTIVE OFFICERS. THESE EXECUTIVE OFFICERS ARE:

Name and Age	Positions and Experience
Patrick R. Donahoe, Age 56	73rd Postmaster General and Chief Executive Officer since December 2010 and a member of the Board of Governors since April 2005. Deputy Postmaster General and Chief Operating Officer from April 2005 until December 2010. Chief Operating Officer and Executive Vice President during the years 2001 to 2005. Senior Vice President, Operations from February 2001 to September 2001.
Ronald A. Stroman Age 59	20th Deputy Postmaster General and member of the Board of Governors of the United States Postal Service since April 2, 2011. Served as Staff Director, Committee on Oversight and Government Relations at the U.S. House of Representatives, from 2009 to April, 2011. Prior to this, served as Managing Director, Office of Opportunity and Inclusiveness, U.S. General Accounting Office, from 2001 to 2009.
Megan Brennan Age 49	Chief Operating Officer and Executive Vice President since December 18, 2010. Previously, Vice President, Eastern Area Operations from December, 2006 to December, 2010, and Vice President, Northeast Area Operations from April, 2005 to December, 2006
Ellis Burgoyne Age 53	Chief Information Officer and Executive Vice President since December 2010. Prior to that, served as Vice President, Area Operations for the Southwest Area from 2006 until 2010. Prior to that, served as Vice President, Delivery and Retail commencing in 2005 until 2006.
Joseph Corbett, Age 52	Chief Financial Officer and Executive Vice President since 2009. Founder and Managing Director of FinSol, LLC, a finance and accounting CFO services firm from 2005 to 2009. Consultant, Chief Financial Officer and Executive Vice President of BearingPoint, Inc., a U.S. government contracting, consulting, and systems integration company, from 2004 to 2005. Executive Vice President and Chief Financial Officer of Intelsat, Ltd., from 1998 to 2004 and Intelsat Controller from 1995 to 1998.
Mary Anne Gibbons, Age 61	General Counsel and Executive Vice President since December 2010. Senior Vice President and General Counsel from December 2003 until December 2010. Vice President and General Counsel from 1999 to December 2003.
Anthony J. Vegliante, Age 60	Chief Human Resources Officer and Executive Vice President since April 2005. Vice President, Labor Relations from February 1999 to April 2005.
Paul Vogel, Age 60	President & Chief Marketing/Sales Officer since December 2010 and President, Mailing and Shipping Services from August 2010 until December 2010. Served as private sector consultant focusing on postal industry strategy and international logistics from 2009 to August 2010. Managing Director of Global Business and Senior Vice President from 2006 to 2009. Vice President, Network Operations Management prior to 2006.

CODE OF ETHICS

All Postal Service employees are required to comply with the Standards of Ethical Conduct for Employees of the Executive Branch ("Standards"). The Standards are published at 5 CFR Part 2635 and cover prohibitions and restrictions on the acceptance of gifts, conflicting financial interests, the obligation of all employees to perform their duties impartially, restrictions on the misuse of government positions, restrictions on certain outside activities, and other related ethical obligations. Postal Service employees are also covered by a set of additional restrictions that apply only to the employees of the Postal Service. These supplemental standards can be found at 5 C.F.R. Part 7001 and focus on limitations on outside employment and outside business activities that could give rise to a conflict with their official duties. The Standards of Conduct and the Supplemental Standards contain many examples to help employees identify and resolve ethical issues. New employees receive ethics training at their orientation and ethics officials provide ethics training throughout the year as required by law and as otherwise deemed appropriate. To ensure that all of our employees can receive timely and accurate ethics advice, we have established a dedicated ethics telephone helpline and an e-mail address that is managed by ethics specialists.

Certain high level employees are also subject to the Senior Financial Managers' Code of Ethics. This Code of Ethics can be found on our website at: *http://about.usps.com/who-we-are/financials/senior-financial-managers-code-of-ethics-2010.pdf*.

ITEM 11 — EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

ROLE OF THE BOARD OF GOVERNORS AND STATUTORY COMPENSATION AND BENEFITS REQUIREMENTS AND LIMITATIONS

The Board of Governors of the Postal Service establishes executive officer compensation and benefits, subject to the requirements and limitations of federal law. The Board has delegated to its Compensation and Management Resources Committee ("Compensation Committee") authority for initial review of management proposals related to compensation and benefits for executive officers. The Compensation Committee, which meets several times throughout the year, is composed solely of presidentially-appointed, Senate-confirmed Governors who are independent of postal management. The Compensation Committee makes recommendations to the full Board for their review and approval.

Federal law governing the Postal Service, set forth in Title 39 of the United States Code, provides that compensation and benefits for all officers in the Postal Service shall be comparable to the compensation and benefits paid for comparable levels of work in the private sector of the economy. The Postal Service is the second largest civilian employer in the nation, with approximately 646,000 career and non-career employees as of the end of fiscal year 2011. The Postal Service operates nearly 214,000 motor vehicles and more than 32,000 retail units. In 2011, the Postal Service delivered 168 billion pieces of mail, almost half of the world's mail, and generated $66 billion in revenue. In 2011, the Postal Service ranked 109th in Fortune Magazine's listing of Fortune Global 500 Companies. By way of comparison, two of our largest competitors ranked 166th and 261st on this list. If the Postal Service were listed on the Fortune 500 annual ranking of America's largest corporations, it would be ranked 34th. The same two of our largest competitors are ranked 48th and 73rd on that list.

Given the Postal Service's size and scope of operations, the comparability requirement in Title 39 would suggest that the Postal Service's executive officer compensation and benefits should be on par with the compensation and benefits of the very largest private sector companies in the United States. Even in these challenging economic times, comparably sized companies typically provide their top executives with annual salaries well in excess of $1 million and total compensation and benefits valued at several million dollars. These compensation packages typically consist of annual and long-term performance incentives, including a combination of cash payments and stock options and a number of benefits and perquisites.

Although the law governing the Postal Service provides that executives and others should be compensated at a level comparable to the private sector, the law does not afford the Governors the tools to achieve a standard of compensation comparable to the private sector. Postal law imposes three different caps on compensation for postal employees. The first cap provides that no officer or employee may be paid compensation "at a rate in excess of the rate for level I of the Executive Schedule under section 5312 of title 5" of the United States Code. 39 U.S.C. § 1003(a). This compensation cap was set at $196,700 for calendar year 2009, $199,700 for calendar year 2010 and $199,700 for calendar year 2011.

With the approval of the Board, however, the Postal Service may develop a program to award a bonus or other reward in excess of the compensation cap discussed above, as long as this does not cause the total compensation paid to the officer in a year to "exceed the total annual compensation payable to the Vice President [of the United States] under [3 U.S.C. §

104] as of the end of the calendar year in which the bonus or award is paid." 39 U.S.C. § 3686(a)-(b). This total compensation cap was $227,300 for calendar year 2009, $230,700 for calendar year 2010 and $230,700 for calendar year 2011. In approving any such program, the Board must determine that the bonus or award is based on a performance appraisal system that makes meaningful distinctions based on relative performance.

In addition, the Board may allow up to 12 officers or employees of the Postal Service in critical senior executive or equivalent positions to be paid total annual compensation up to "120 percent of the total annual compensation payable to the Vice President [of the United States] under [3 U.S.C. § 104] as of the end of the calendar year in which such payment is received." 39 U.S.C. § 3686(c). Based on the Vice President's salary for calendar years 2009, 2010 and 2011, this compensation cap was $272,760 for calendar year 2009, $276,840 for calendar year 2010 and $276,840 for calendar year 2011.

By law, postal employees, including executive officers, are entitled to participate in either the Civil Service Retirement System or Federal Employees Retirement System, depending on when their federal employment began. These retirement systems are described later in this compensation discussion and analysis. In addition, in order to remain competitive with comparable employment in private industry and other parts of the federal government, postal policy also authorizes certain additional benefits for all officers of the Postal Service, including executive officers. These include participation in the Federal Employees Health Benefits plan, paid life insurance, a periodic physical examination and parking. Other than changes required by law, the Board must authorize any increases to benefits for officers.

Compensation for postal executive officers is significantly below that of the private sector. In 2010, Towers Watson found that USPS executive base salaries are significantly below market when compared against published survey data of comparable jobs in the private sector. Although market data for equity or other long-term incentives was not a focus of that analysis, inclusion of such data would likely cause USPS executive total compensation to fall even further from the comparator marketplace.

COMPENSATION PHILOSOPHY AND OBJECTIVES

The Board recognizes that there is a significant disconnect between the comparability requirement and the compensation caps in the law governing the Postal Service and that the various compensation caps do not enable the Board to provide compensation and benefits for executive officers that are fully comparable to the private sector. The Board also recognizes that many of the compensation and benefit tools available in the private sector, such as equity ownership, are not available to the Postal Service, given its status as part of the federal government. These limitations make it difficult for the Postal Service to compete in the marketplace for executive officers and to retain current executive officers.

To attempt to achieve some level of comparability within the confines of the law, the Board has designed a compensation system that balances amounts paid as salary to executives in a given year, with the ability of the executive to earn additional compensation by meeting performance goals and objectives; a portion of this compensation may need to be deferred because of the compensation caps. The financial challenges facing the Postal Service significantly influenced the decisions on compensation for fiscal year 2011, as customers continue to change the way they use the Postal Service's products and services. The Board was also mindful of the impact of the economy and the political arena on the Postal Service's business.

Within the confines of its legislative authority, the Board's philosophy is that:

- There should be a strong connection between individual executive compensation and the Postal Service's performance on a number of dimensions, including service, net income and productivity.
- Compensation and benefits should be designed to attract and retain top organizational contributors to ensure the Postal Service has the caliber of executives who will enable it to operate at the highest levels of performance and productivity.
- Lump sum incentives should be set to motivate executives to improve performance continuously on a long-term basis and to perform above the annually-established goals and objectives. If individual performance exceeds the goals and objectives set for the year, the employee should receive additional compensation. Likewise, if overall performance falls below the annual goals and objectives, the individual should be paid less.
- A significant amount of the executive's compensation should be at risk and the "at-risk"

amount should increase as the executive's level of responsibility increases.

- Innovation, effectiveness as an agent for change, the ability to balance day-to-day priorities and long-term strategies, and organizational value as defined by the achievement of key corporate goals and objectives should be rewarded.
- Executive compensation should be fair and equitable internally, recognizing the width and breadth of the responsibilities of the Postal Service's executives.
- Executive success is defined by a number of factors, including financial returns, the quality of service the Postal Service provides, the results achieved by the executive's actions to enhance the organization's efficiency and overcome challenges and whether an executive met established individual goals. For these reasons, lump sum incentives may be appropriate even in years in which the Postal Service sustains financial losses. This is especially true where the Postal Service maintained service levels while significantly reducing costs.

THE COMPENSATION PROGRAM

In 2007, after enactment of the Postal Act of 2006, the Compensation Committee of the Board of Governors retained the services of Watson Wyatt (now Towers Watson), an independent consulting firm specializing in executive compensation matters, to assist the Board in implementing the compensation provisions of the Postal Act of 2006 and to review and update the overall program for officer compensation and benefits.

The Compensation Committee recommended and the Board approved a salary band for the Postmaster General to be set at the legislative salary cap. In doing so, the Board's objectives were to design a compensation program that optimized the legislative flexibility granted by the Postal Act of 2006, reduced internal pay compression, improved external marketplace competitiveness and honored legislative constraints and existing pay ranges, consistent with the recommendations from Towers Watson. For the other executive officers, the Board set pay bands based on salary relationships of comparable executive officers in the comparator external market. In general, the Board has maintained these types of pay band relationships since 2007.

When the Governors appointed the current Postmaster General, they set his salary at the legislative salary cap. Given the Postal Service's significant financial challenges when he assumed office, the current Postmaster General asked the Governors not to award him any additional compensation, beyond salary and the general types of benefits provided to postal executives. The Governors agreed.

Over the years, the Governors have authorized the Postmaster General to establish actual salaries for the other executive officers, within the confines of the salary ranges established by the Governors. For calendar year 2011, after reviewing recommendations from the Postmaster General and the Compensation Committee and in light of the Postal Service's dire financial condition, the Governors froze salary ranges and salaries.

In 2011, the Postal Service continued to employ a national performance assessment program ("NPA") to set annual performance goals and metrics that vary among executive officers and are weighted to reflect appropriately the degree to which an executive is able to influence the overall performance of the Postal Service. Annual NPA metrics and targets generally take into consideration the Postal Service's performance during the prior year and particular challenges the Postal Service expects to face during the upcoming year. The NPA places emphasis on objective, measurable performance indicators. The Governors also set individual metrics and targets for the Postmaster General and Deputy Postmaster General and authorize the Postmaster General to establish individual metrics and targets for other officers.

Generally, the Board establishes annual Pay-for-Performance (PFP) incentive opportunities to provide incentives and to reward the Postmaster General and the Deputy Postmaster General for reaching various levels of performance. The Postmaster General establishes annual PFP incentive opportunities to provide incentives and to reward the other executive officers for reaching various levels of performance. Incentive payouts are not made for a particular goal if the Postal Service or the individual fails to meet minimum acceptable performance standards. While, in some years, annual PFP incentives are paid out in cash or deferred for future payment where required due to the compensation caps, it was determined that, in light of the Postal Service's financial condition, no performance awards would be paid for fiscal year 2011. This will be the fourth consecutive year that compensation for executive officers has been impacted by either a freeze in salary and/or a non- payment of performance lump sums.

The Postal Service has continued to use the NPA process to measure performance during fiscal year 2011 even though there will be no associated compensation. NPA performance goals and rewards fall into several categories. These include areas that an officer may directly influence, such as service, efficiency, employee satisfaction, and productivity, as well as those that are more susceptible to being affected by general economic conditions, such as revenue generation.

The Board believes that this mix of goals has helped the Postal Service to continue to deliver high-quality service even in the face of an unsettled economy. Particularly in a troubled economy, in order to remain viable, the Postal Service must serve its customers with the highest levels of efficiency and productivity. Measuring results and sharing information with executive officers on their performance is one way that the Postal Service sustains this performance.

For each goal, the Postmaster General establishes indicators identifying the type of performance that will enable the Postal Service to achieve or surpass the goal. These performance indicators are aligned at the corporate, functional, and individual levels and are weighted. The higher an individual's position is in the organization, the more his or her PFP goals will be tied to overall corporate performance. The executive officers' goals are aligned with national performance goals and linked to the overall success of the Postal Service.

Once the goals and indicators are established, executive officers are advised as to what the Postal Service expects of them in terms of performance during the year, how their performance will impact the entire Postal Service, and in years when performance incentives are authorized, the potential level of performance-based incentives they can expect depending on the Postal Service's and their individual performance. Under this program, an individual executive officer can receive a rating of Non-Contributor, Contributor, High Contributor or Exceptional Contributor, with a numerical rating within each category, depending on how the Postal Service performs on the national indicators and the individual's performance, as determined by the Postmaster General. As shown in the chart below, a rating of Non-Contributor would result from an overall numerical rating of 1 to 3. A rating of Contributor would result from a numerical score of 4 to 9. A rating of High Contributor would result from a score of 10 to 12 and a rating of Exceptional Contributor would result from a score of 13 to 15.

Overall Performance Rating

Adjective Rating	Number rating
Exceptional Contributor (EC)	13, 14, 15
High Contributor (HC)	10, 11, 12
Contributor (C)	4 to 9
Non Contributor (NC)	1, 2, 3

In years when a salary freeze is not in effect and when performance incentives are authorized, the individual executive officer's performance rating would make the officer eligible for an increase to base salary as well as a performance-based lump sum payment. Due to statutory cap limitations, increases to the maximum of the salary range for executive officers generally follow the percentage increase to the Executive Schedule for any given year. Any salary increases for executive officers are limited by these maximums and are solely performance based as determined by the Postmaster General. Lump sum incentive payments are based on the executive officer's performance rating given by the Postmaster General and multiplied by a range of 1.33% to 2.50% based on the degree to which the individual has achieved previously set individual goals and metrics. The Postmaster General's discretion on PFP incentives for executive officers in a given year is limited by the Postal Service's overall performance on NPA goals and metrics. Generally, officer performance scores must average to the Postal Service's overall NPA performance score for the fiscal year.

Salary increases, if any, are determined after the end of the fiscal year, and any new salaries become effective for the following calendar year. Although management achieved very significant accomplishments in addressing the many challenges the Postal Service faced in fiscal year 2011, the Governors determined that salaries should remain frozen in calendar year 2012 in light of the Postal Service's current financial situation. For the same reason, the Governors did not award the Postmaster General a performance incentive for fiscal year 2011. Likewise, the Postmaster General, with the approval of the Governors, determined that performance incentives should not be paid for fiscal year 2011 for the other named executive officers. Although the Postal Service's financial situation caused the Governors to freeze salaries and not to allow incentive awards, the Governors noted that, despite the significant continuing decline in mail volumes over the past several years, management has continued to take aggressive actions within its control to reduce costs, maintain excellent service and secure revenue. Despite declining volume, management improved total factor productivity by reducing the workforce, overtime, and supplier expenses, as well as through a number of other process improvement efforts. In addition to maintaining high levels of service, management also maintained employee satisfaction, introduced a number of new products and services, increased customer access and offered mailers pricing incentives to help stem the volume decline. Management continued to streamline operations, closing a number of facilities and establishing a process to optimize network and retail operations. The Governors also noted that the Postal Service received an unqualified opinion from its external auditors as to the effectiveness of internal controls. Finally, management also took significant actions to pursue legislative reform in areas key to the Postal Service's ability to provide universal service in the future.

Components of the executive officer compensation and benefits program are further outlined below.

BASE SALARY

Base salaries provide a level of financial security that is appropriate for the executive's position within the Postal Service. Within the confines of law, base salaries are scaled within pay ranges designed to be competitive with the market median. As discussed above, maximum payouts in a given year are set by federal law. Executive officer salaries are reviewed at least annually and adjusted, as appropriate, to reflect factors such as individual performance, range of responsibilities, value and contribution to the organization, and experience. However, as discussed above, the Governors decided to freeze executive officer salaries for calendar year 2012, continuing the freeze already in place for calendar year 2011.

ANNUAL INCENTIVE

Annual incentives serve as a mechanism for adjusting total compensation levels commensurate with the attainment of planned results, thereby ensuring affordability and appropriate return to the Postal Service. As discussed above, the Postal Service uses the NPA program to set annual corporate performance goals and metrics. The Governors set the goals and indicators for the Postmaster General and the Deputy Postmaster General, and the Postmaster General establishes goals and indicators for the other executive officers. The Postmaster General's and the Deputy Postmaster General's performance is determined based on the degree to which they have achieved the previously -set goals and metrics. Likewise, executive officers' individual performance ratings are determined by the Postmaster General based on the degree to which the individual has achieved the previously -set individual goals and metrics. As discussed above, performance incentives will not be paid for fiscal year 2011 due to the Postal Service's dire financial condition.

OTHER COMPENSATION INCENTIVES

Executive officers are also eligible for performance awards for specific activities that reflect a high degree of leadership. Only a small number of these individual awards are given out in a typical year. For fiscal year 2011, no performance awards of this type will be awarded. In addition, executive officers are eligible for retention and recruitment incentives designed to attract and retain highly talented and marketable individuals in key postal positions. The payment of some of these awards may be deferred, in whole or in part, due to the Postal Service's compensation limits.

RETIREMENT ANNUITIES

Officers are covered either by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Both systems have a defined benefit component and a defined contribution component. CSRS and FERS service is creditable for Medicare coverage. FERS service is creditable for Social Security.

CSRS Defined Benefit: The CSRS Basic Benefit annuity is a percentage of the high-3 salary multiplied by years of service. The percentage is 1.5% for the first 5 years of service, plus 1.75% from 5 years to 10 years of service and 2% for all years of service thereafter. Optional retirement thresholds are age 55 with 30 years of service, age 60 with 20 years of service, and age 62 with 5 years of service, with a requirement of completing at least 5 years of creditable civilian service. The annuity is fully indexed to the Consumer Price Index (CPI). Disability, early retirement, deferred and survivor benefits are available.

FERS Defined Benefit: The FERS Basic Benefit annuity is 1 percent of high-3 salary per year of service, or 1.1 percent for retirement at age 62 with at least 20 years of service. Optional retirement thresholds are the Minimum Retirement Age (MRA is 55 to 57 depending on year of birth) with 30 years of service, age 60 with 20 years of service, age 62 with 5 years of service, or MRA with 10 years of service (at a reduced benefit), with a requirement of completing at least 5 years of creditable civilian service. Employees who retire at MRA with 30 years of service, or at age 60 with 20 years of service, receive a retirement supplement approximating the value of Social Security benefits attributable to federal service; this benefit is paid until age 62. Beginning at age 62, the annuity is indexed to CPI, fully when the CPI increase is 2 percent or less, at 2 percent when the CPI increase is between 2 and 3 percent, and at CPI - 1 when the CPI is at least 3 percent. Disability, early retirement, deferred and survivor benefits are available.

Defined Contribution: The Thrift Savings Plan (TSP) is similar to 401(k) plans. CSRS and FERS employees may contribute up to the indexed IRS maximum ($16,500 in 2011). There is no Postal Service contribution for CSRS employees. For FERS employees, after an initial waiting period of 6 months to a year, the Postal Service makes an automatic contribution of 1 percent of basic pay and a matching contribution of up to 4 percent of basic pay, for a total employer contribution of up to 5 percent of basic pay. Employees who will be at least age 50 in the year of contribution may make a separate catch-up contribution up to the indexed IRS maximum ($5,500 in 2011). TSP investment options are a government securities fund; index funds that track the Barclays Capital Aggregate Bond Index, the S&P 500, the Wilshire 4500, and the Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) stock index; and lifecycle funds.

SUPPLEMENTAL NON-QUALIFIED DEFERRED COMPENSATION

Where appropriate and on a highly selective basis, the Postal Service offers supplemental non-qualified deferred compensation as a recruitment or retention tool.

LIFE INSURANCE

Officers are entitled to basic group life insurance coverage under the Federal Employees Group Life Insurance (FEGLI) Program in the amount of their annual basic salary, rounded up to the next $1,000, plus $2,000. If basic coverage is held, an officer will also receive an additional $10,000 coverage (Option A) and Option B coverage up to three times their salary. All premiums for Option A, Option B, and basic coverage are paid by the USPS. At their own expense, officers may elect additional Option B coverage in an amount equal to two times their salary. Also at their own expense, officers may elect Option C, family optional insurance coverage, of up to 5 multiples of $5,000 for their spouse and $2,500 for each eligible dependent child. Officers continuously covered under FEGLI for the 5 years immediately preceding retirement, or since the first opportunity, may continue coverage during retirement (if entitled to an immediate annuity). USPS pays former officers an actuarially determined lump sum to cover the cost of Option A premiums during retirement to retiring officers.

HEALTH BENEFITS

The Postal Service participates in the Federal Employees Health Benefits ("FEHB") program, which allows all career employees to enroll in one of a number of self only or self and family health benefit plans offered as part of this program. Currently, the Postal Service pays the full cost of the premium for its officers and executives. Beginning in January 2012, the Postal Service will, over a three-year period, increase the percentage its officers and executives pay until the percentage matches the percentage paid by employees in the rest of the federal government. In 2012, the Postal Service share of the premium will be reduced from 100 percent to 91 percent of the federal weighted average premium, limited to not more than 94.75 percent of the total premium for any given plan, and enrolled officers and executives will pay the balance of the premium for the plan they select.

Employees who retire with immediate entitlement to an annuity are eligible to continue FEHB coverage into retirement as long as they have participated in an FEHB plan for the five years preceding their retirement or since their first opportunity. Officers are under the same cost sharing formula as other Postal Service and Federal retirees—the Postal Service pays according to the federal premium formula, which is 72 percent of the federal weighted average premium, limited to not more than 75 percent of the total premium for any given plan, with the retiree paying the balance of the premium for the plan they select.

OTHER BENEFITS

To remain competitive with the comparator marketplace, the Postal Service also offers the following additional benefits to its executive officers: periodic physical examinations, parking, financial counseling services, employer-paid life insurance premiums, and membership in up to two airline clubs per year.

FISCAL YEAR 2011 EXECUTIVE OFFICER COMPENSATION

SUMMARY COMPENSATION TABLE

Name and principal position	Year	Salary ($)	Bonus ($)	Non-equity incentive plan compensation ($)	Change in pension value and Nonqualified deferred compensation earnings ($)	All other compensation ($)	Total ($)
(a)	(b)	(c)	(d)	(g)	(h)	(i)	(j)
Patrick R. Donahoe [1]	FY11	271,871	-	-	81,954	30,404	384,229
Postmaster General & CEO	FY10	247,615	-	31,100	195,472	6,901	481,088
	FY09	240,000	-	-	317,538	39,591	597,129
John E. Potter [2]	FY11	53,239	-	286,840	(24,427)	16,858	332,510
Former Postmaster General & CEO	FY10	273,296	-	228,088	219,095	77,939	798,418
	FY09	265,320	-	-	393,054	76,276	734,650
Joseph Corbett	FY11	239,000	-	30,000	23,376	18,107	310,483
Chief Financial Officer & Executive VP	FY10	236,231	-	58,600	19,950	18,901	333,682
	FY09	150,385	75,000	-	11,891	7,121	244,397
Megan Brennan	FY11	225,308	25,000	-	67,512	41,176	358,996
Chief Operating Officer & Executive Vice President	FY10	-	-	-	-	-	-
	FY09	-	-	-	-	-	-
Ellis Burgoyne	FY11	220,846	25,763	-	228,384	33,695	508,688
Chief Information Officer & Executive Vice President	FY10	-	-	-	-	-	-
	FY09	-	-	-	-	-	-
Anthony J. Vegliante	FY11	240,000	-	60,000	56,931	12,736	369,667
Chief Human Resources Officer & Executive VP	FY10	236,923	-	37,800	101,777	9,342	385,842
	FY09	230,000	-	-	199,763	10,627	440,390

Notes:

[1] Mr. Donahoe was appointed Postmaster General & CEO as of December 4, 2010. Mr. Donahoe's FY11 (prior to December 4, 2010), FY10 and FY09 data reflect compensation as the Deputy Postmaster General & COO.
[2] Mr. Potter was Postmaster General & CEO through December 3, 2010, for the FY11 period.

Column (c) Salaries for executive level officers were frozen for calendar year 2011. The salary amounts vary from FY11, FY10 and FY09 because salaries are based on the calendar year and not the fiscal year. Therefore, FY11 salary amounts include a portion of calendar year 2010 salary amounts, FY10 salary amounts include a portion of calendar year 2009 salary amounts and FY09 salary amounts include a portion of calendar 2008 salary amounts. Ms. Brennan and Mr. Burgoyne were not named executive officers in FY10 or FY09 and, as such, information for these fiscal years is not reported for them.

Column (d) Pursuant to a contract with the Postal Service, the amount shown for Mr. Corbett in this column was awarded as a recruitment incentive in FY09. Ms. Brennan and Mr. Burgoyne were each paid $25,000 in FY11 as a recruitment lump-sum when they were promoted to their respective positions as Chief Operating Officer and Chief Information Officer. In addition, Mr. Burgoyne was awarded $763 in his previous position as Vice President, Area Operations.

Column (g) The amounts in this column reflect the performance-based incentive compensation awarded to executive officers in prior fiscal years; as *noted above, this incentive compensation was not awarded for FY11. Former Postmaster General Potter's non-equity incentive plan compensation was deferred due to the compensation cap and is being paid in ten annual installments as he has retired from Postal Service employment. The amount for FY10 for Mr. Potter includes a lifetime achievement award and a severance payment per his contract. Pursuant to Mr. Corbett's employment contract, his non-equity incentive plan compensation includes $30,000 in deferred performance-based compensation for FY10 and FY11. Pursuant to a retention contract with the Postal Service, Mr. Vegliante was awarded a performance-based retention of $60,000 for FY11; this amount was deferred. Any amounts that could not be paid to an executive officer due to the compensation cap or their contract were deferred for future payment.*

Column (h) Mr. Donahoe, former Postmaster General Potter, Mr. Burgoyne and Mr. Vegliante participate in the Civil Service Retirement System (CSRS), which is a defined benefit plan. Mr. Corbett and Ms. Brennan participate in the Federal Employees Retirement System (FERS), a portion of which is a defined benefit plan. The calculation of retirement annuities under CSRS and FERS is explained in the Pension Benefits table, the associated note and in the Retirement Annuities section of the Compensation Discussion and Analysis. The amounts shown in column (h) for each of these individuals are the amounts by which the value of their annuities has increased since the end of the prior fiscal year. "Nonqualified deferred compensation earnings" is defined as above-market earnings on deferred income. There were no reportable amounts of non-qualified deferred compensation earnings for the named executive officers in FY2011, with the exception of Mr. Corbett, whose above-market earnings on deferred income was $238.

Column (i) For all executive officers listed, the 'All Other Compensation" category includes financial planning services, Thrift Savings Plan employer matching contribution for FERS employees, non-cash awards, parking, physical examinations, life insurance premiums paid for by the Postal Service, airline clubs, and relocation costs. Security costs valued at $19,471 are also included for the Postmaster General.

GRANTS OF PLAN-BASED AWARDS

The following table presents information regarding potential non-equity incentive awards to the named executive officers for fiscal year 2012. Whether executive officers receive an award and, if so, the amount of an award for fiscal year 2012 will depend on the Postal Service's and the individual's performance.

Name	**Grant Date**	**Estimated Future Payouts Under Non-Equity Incentive Plan Awards**		
		Threshold ($)	**Target ($)**	**Maximum ($)**
(a)	(b)	(c)	(d)	(e)
Patrick R. Donahoe	October 2011	14,728	33,221	103,815
Joseph Corbett	October 2011	12,715	28,680	89,625
Megan Brennan	October 2011	12,502	28,200	88,125
Ellis Burgoyne	October 2011	12,236	27,600	86,250
Anthony J. Vegliante	October 2011	12,768	28,800	90,000

***Note:** Columns (c)-(e). The USPS Pay-for-Performance (PFP) program relies on a 15-point scale with clearly defined and transparent corporate goals. The PFP plan target in any given year is set at a rating of 6. Incentives are not paid for any rating below or equal to 3. The maximum threshold for payment is set at a rating of 15. Individual ratings vary but the corporate score is used as the regulator. As noted above, no incentives were paid for FY 2011.*

PENSION BENEFITS

The table below shows the present value of accumulated pension benefits payable to the named executive officers.

Name	Plan name	Number of years credited service (#)	Present value of accumulated benefit ($)
(a)	(b)	(c)	(d)
Patrick R. Donahoe	CSRS Annuity	36 Years	3,254,725
John E. Potter	CSRS Annuity	32.5 Years	3,179,788
John E. Potter	USPS Pension Benefit	32.5 Years	1,350,318
Joseph Corbett	FERS Annuity	3 Years	55,818
Megan Brennan	FERS Annuity	25 Years	456,198
Ellis Burgoyne	CSRS Annuity	33 Years	2,477,835
Anthony J. Vegliante	CSRS Annuity	34 Years	2,650,816

Note: Column (d) Former Postmaster General Potter is the only USPS officer who was awarded a USPS Pension Benefit pursuant to contractual agreement. The amount in the third line in column (d) above for Mr. Potter is payable for his attainment of required performance objectives over the six-year period from June 2001 – June 2007 and was not based on Mr. Potter's years of service to the Postal Service. In 2007, the Board discontinued the USPS Pension Benefit and froze the amount of that benefit. Instead, from that time until his retirement, Mr. Potter was eligible for a performance incentive each year if he met required performance objectives. The above amount of USPS Pension Benefit is being paid to former Postmaster General Potter in monthly installments as he has retired from postal service employment. A survivor annuity equal to 55% of the amount payable to Mr. Potter will be paid to his spouse should Mr. Potter pre-decease her. All officers, including former Postmaster General Potter, are eligible for CSRS or FERS retirement benefits available to career employees of the Federal Government. These benefits are described in the Retirement Annuities section of the Compensation Discussion and Analysis. The present value of the accumulated CSRS or FERS benefit represents the value of the pension over the individual's actuarial lifetime, as of September 30, 2011. Mr. Donahoe, Mr. Potter, Mr. Burgoyne and Mr. Vegliante participate in CSRS, and Mr. Corbett and Ms. Brennan participate in FERS. Mr. Potter has retired and Mr. Donahoe, Mr. Burgoyne and Mr. Vegliante are eligible for retirement, the calculation of which is described in the Retirement Annuities section of the Compensation Discussion and Analysis. The valuation for Ms. Brennan assumes she has reached retirement eligibility. The valuation for Mr. Corbett assumes that he has satisfied vesting requirements for retirement; however, because of his short tenure with the Postal Service, his retirement annuity has not vested.

NONQUALIFIED DEFERRED COMPENSATION

The following table presents information regarding the contributions to, and earnings on, the named executive officers' deferred compensation balances during the fiscal year ended September 30, 2011 and also shows the total deferred amounts for the named executive officers as of September 30, 2011.

Name	Executive contributions in last FY ($)	Aggregate earnings in last FY ($)	Aggregate balance at September 30, 2011 ($)
(a)	(b)	(c)	(d)
Patrick R. Donahoe	-	302	7,655
John E. Potter	10,000	34,865	815,788
Joseph Corbett	30,000	1,634	71,508
Anthony J. Vegliante	60,000	2,833	64,033

Notes: Column (b) The amounts in this column represent amounts deferred due to the compensation cap or contract agreements. The amount shown for former Postmaster General Potter reflects an award to him that was deferred as of Dec. 3, 2010, the date he retired from the Postal Service. The amounts shown for Mr. Corbett and Mr. Vegliante reflect lump-sum retention payments required by their employment agreements which have been deferred.

Column (c) The Postal Service calculates interest on deferred compensation semi-annually at 5.0% per year. Interest is prorated from the relevant pay period of the deferral.

Column (d) Former Postmaster General Potter's balance includes awards and performance incentives he earned in the 1990s before becoming Postmaster General, performance incentives he earned during the period from 2001 to 2008 and interest paid on these amounts. This total amount for Mr. Potter is being paid in equal installments over a 10-year period pursuant to his contract with the Postal Service, the first payment of which was made in January 2011. Mr. Potter has retired from Postal Service employment.

DIRECTOR COMPENSATION

The following table presents information regarding the compensation of the members of the Board of Governors.

Name	Fees earned or paid in cash ($)	All other compensation ($)	Total ($)
Louis J. Giuliano	36,900	-	36,900
Mickey D. Barnett	37,500	-	37,500
James H. Bilbray	40,200	-	40,200
Carolyn Lewis Gallagher	7,467	-	7,467
Alan C. Kessler	31,600	-	31,600
Thurgood Marshall, Jr.	39,900	-	39,900
James C. Miller III	38,700	-	38,700
Dennis J. Toner	35,200		35,200
Ellen C. Williams	36,900	-	36,900

Note: Each Governor receives a basic stipend of $30,000 per year plus $300 per day for not more than 42 days of meetings each year. Governors Gallagher and Kessler were members of the Board during FY11. Governor Gallagher's term ended and Governor Kessler resigned from the Board during the fiscal year.

POTENTIAL PAYMENTS UPON TERMINATION

As described in the Compensation Discussion and Analysis, in 2009 the Postal Service entered into an employment agreement with Joseph Corbett, the Chief Financial Officer, for recruitment and retention purposes. Mr. Corbett's agreement provides for deferred compensation payable in installments commencing on the date of his separation from the Postal Service or October 22, 2019, whichever is later. In 2010, the former Postmaster General entered into an employment agreement with Mr. Vegliante. That agreement was amended on November 14, 2011. A copy of the amendment is attached hereto as Exhibit 10.6. As amended, the agreement clarifies that Mr. Vegliante's retention incentive is performance-based and provides for his 2011 deferred compensation to be paid no sooner than one year after his departure from the Postal Service.

The Postmaster General and all of the other named executives are subject to the standard policies governing the CSRS or FERS, as described in the Compensation Discussion and Analysis. The present value of these CSRS and FERS benefits are found in the Pension Benefits table in the Compensation section of this report. The information below describes and quantifies certain compensation, in addition to that due pursuant to CSRS or FERS, that would become payable under existing plans and arrangements if the named executive officer's employment had terminated on September 30, 2011. Additionally, pursuant to statutes and regulations generally applicable to federal employees, the named executives would be entitled to receive the federal employer's standard contribution toward retiree health benefits, in the event they have qualifying service and participated in the Federal Employees Health Benefits Plan for the requisite period of time prior to retiring.

DEFERRED COMPENSATION

All federal employees, including Postal Service employees, are subject to annual compensation limits established pursuant to federal statutes and regulations. When amounts earned by federal employees cannot be paid because of these compensation limits, these payments are deferred until a year in which their payment would not cause total annual compensation paid to the employee to exceed the compensation limit, or the year in which an employee leaves federal service, whichever occurs first. Named executive officers appearing in the Nonqualified Deferred Compensation table in the Executive Officer Compensation section of this report have deferred compensation in the amounts indicated therein. These amounts would have been paid to them in a lump-sum or pursuant to their contract with the Postal Service following their departure, had they ended their Postal Service employment on September 30, 2011. Mr. Corbett's employment agreement provides for deferred incentives linked in part to his performance. Mr. Corbett began accruing deferred performance-based compensation at the end of fiscal year 2010. When Mr. Corbett concludes his Postal Service employment, or on October 22, 2019, if that date is later than Mr. Corbett's departure from the Postal Service, his deferred compensation will be paid to him in three approximately equal annual installments. Mr. Vegliante's 2011 deferred compensation will be paid to him no sooner than one year after his departure from the Postal Service.

SUPPLEMENTAL PENSION BENEFIT

The Governors have not authorized a supplemental pension benefit for any executive officer at this time

SEVERANCE PAYMENT

Mr. Corbett is entitled to a severance payment of $230,000, in the event the Postal Service terminates his employment for any reason other than for cause or breach of contract.

INSURANCE BENEFITS

The Governors have not authorized supplemental insurance benefits for any executive officer at this time. The insurance benefits to which all postal executives are entitled are described above.

OUTPLACEMENT ASSISTANCE

The Governors have not authorized any outplacement assistance for any executive officer at this time.

ACCRUED ANNUAL LEAVE

All Postal Service employees are entitled to receive and accrue paid days off, known as annual leave. Upon their separation from the Postal Service, all employees, including the named executive officers, are entitled to be paid, in a lump-sum, the value of all accrued annual leave. The table below shows the accrued value of the annual leave of the named executive officers, as of September 30, 2011.

Name	Value of accrued annual leave ($)
Patrick R. Donahoe	188,331
Joseph Corbett	30,335
Megan Brennan	77,166
Ellis Burgoyne	13,048
Anthony J. Vegliante	236,307

COMPENSATION COMMITTEE REPORT

The Compensation and Management Resources Committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on such review and discussions, the Compensation and Management Resources Committee recommended to the Governors that the Compensation Discussion and Analysis be included in this Report.

The Compensation and Management Resources Committee

Ellen C. Williams, Chairman
Mickey Barnett, Member
Louis J. Giuliano, Member
Dennis J. Toner, Member

ITEM 12 — SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the Government of the United States," we do not issue equity securities.

ITEM 13 — CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

CERTAIN TRANSACTIONS

We enter into significant transactions with other government agencies, as disclosed throughout this report and the financial statements.

DIRECTOR INDEPENDENCE

All of the Governors of the Postal Service Board of Governors who are currently serving and have been appointed by the President of the United States with the advice and consent of the Senate are independent based on the New York Stock Exchange definition of independence.

ITEM 14 — PRINCIPAL ACCOUNTANT FEES AND SERVICES

In 2002, the Board of Governors selected Ernst & Young LLP as its independent auditor to perform external auditing services. In October 2009, the contract was extended to February 2014 with two option years to February 2016. As with previous contracts for external audit services, Ernst & Young LLP will not perform consulting work for us for the duration of the contract. Fees for audit services totaled approximately $10.4 million in 2011, $10.2 million in 2010, and approximately $8.2 million in 2009, including fees associated with the annual audit, including the reviews of the Postal Service's quarterly reports on Form 10-Q and testing of management's internal control assessment in accordance with the Sarbanes-Oxley Act in 2011 and 2010.

Part IV
Financial Review

ITEM 15 — EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(A)(1) AND (2) FINANCIAL STATEMENTS; FINANCIAL STATEMENT SCHEDULES

In 2002, the Board of Governors selected Ernst & Young LLP to audit the Postal Service's financial statements, together with the notes thereto. The report of Ernst & Young LLP dated November 15, 2011, is presented on page 62 of this Form 10-K. The financial statements included are the Statement of Operations, the Balance Sheets, the Statements of Changes in Net Deficiency, the Statements of Cash Flows and the Notes to the Financial Statements.

1. FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm — page 62.

Statements of Operations for the Years Ended September 30, 2011, 2010, and 2009 — page 63.

Balance Sheets as of September 30, 2011, and 2010 — pages 64-65.

Statements of Changes in Net Deficiency for the Years Ended September 30, 2011, 2010, and 2009 — page 66.

Statements of Cash Flows for the Years Ended September 30, 2011, 2010, and 2009 — page 67.

Notes to Financial Statements — pages 68-84.

2. FINANCIAL STATEMENT SCHEDULES

Operating Statistics from the Years Ended September 30, 2007 to 2011 — pages 85-88.

Financial History Summary from the Year ended September 30, 2007 to 2011 — page 89.

All other financial statement schedules have been omitted because they are not applicable or the required information is included in the Postal Service's financial statements or the notes thereto.

(A)(3) EXHIBITS

Exhibit Number	Description of Exhibit
10.1	Employment/Compensation Contract with John E. Potter, Postmaster General and Chief Executive Officer, as of August 8, 2007, as amended November 25, 2008 (filed with the PRC on November 26, 2008, as Exhibit No. 10.1 to the Annual Report on Form 10-K for the year ended September 30, 2008).
10.2	Employment/Compensation Contract with Joseph Corbett, Chief Financial Officer (filed with the PRC on January 29, 2009, as Exhibit No. 10.1 to the Current Report on Form 8-K).
10.3	Employment/Compensation Contract with Paul Vogel, President and Chief Marketing/Sales Officer, dated July 27, 2010 (filed with the PRC on November 15, 2010, as Exhibit No. 10.5 to the Annual Report on Form 10-K).
10.4	Amendment to employment/compensation contract with Paul Vogel, President and Chief Marketing/Sales Officer, dated November 14, 2011.
10.5	Employment/Compensation Contract with Anthony Vegliante, Chief Human Resources Officer and Executive Vice President (filed with the PRC on November 15, 2010, as Exhibit No. 10.1 to the Current Report on Form 8-K).
10.6	Amendment to employment/compensation contract with Anthony Vegliante, Chief Human Resources Officer and Executive Vice President, dated November 14, 2011.
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Report of Independent Registered Public Accounting Firm

The Board of Governors of the United States Postal Service

We have audited the United States Postal Service's internal control over financial reporting as of September 30, 2011, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The United States Postal Service's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the United States Postal Service's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the United States Postal Service maintained, in all material respects, effective internal control over financial reporting as of September 30, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Oversight Board (United States), the balance sheets of the United States Postal Service as of September 30, 2011 and 2010, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2011 of the United States Postal Service and our report dated November 15, 2011 expressed an unqualified opinion thereon that included an explanatory paragraph regarding the United States Postal Service's ability to generate sufficient cash flow to meet all of its financial obligations throughout their fiscal year ending September 30, 2012.

/s/ Ernst & Young LLP

McLean, Virginia
November 15, 2011

Report of Independent Registered Public Accounting Firm

The Board of Governors of the United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2011 and 2010, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2011. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2011, in conformity with US generally accepted accounting principles.

As discussed more fully in Note 2 to the financial statements, the United States Postal Service, an independent establishment of the executive branch of the Government of the United States, is dependent upon future actions of the Government to continue its operations in the ordinary course as a result of increasing operating losses and near term statutory funding requirements for employee benefit obligations. Losses in recent periods have increased primarily due to sustained declines in mail volume, and statutory and regulatory restrictions have constrained the ability of the Postal Service to implement strategies to improve efficiency, reduce costs and increase revenues. On September 30, 2011, legislation was enacted that changed the due date of a $5.5 billion payment required by Public Law 109-435, the *Postal Accountability and Enhancement Act,* to not later than November 18, 2011. The Postal Service does not expect to have sufficient cash to meet this obligation and a related additional obligation due by September 30, 2012 for $5.6 billion. Accordingly, management expects, but no assurances can be given, that additional legislation will be enacted in fiscal year 2012 to address the short-term funding requirements of the United States Postal Service.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the United States Postal Service's internal control over financial reporting as of September 30, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 15, 2011 expressed an unqualified opinion thereon.

In accordance with *Government Auditing Standards,* we also have issued our report dated November 15, 2011 on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/ Ernst & Young LLP

McLean, Virginia
November 15, 2011

STATEMENTS OF OPERATIONS

(Dollars in millions)	Years Ended September 30, 2011	2010	2009
Operating revenue	$ 65,711	$ 67,052	$ 68,090
Operating expenses			
Compensation and benefits	48,310	48,909	50,883
Retiree health benefits	2,441	7,747	3,390
Workers' compensation	3,672	3,566	2,223
Transportation	6,389	5,878	6,026
Other	9,822	9,326	9,308
Total operating expenses	70,634	75,426	71,830
Loss from operations	**(4,923)**	**(8,374)**	**(3,740)**
Interest and investment income	28	25	26
Interest expense	(172)	(156)	(80)
Net loss	**$ (5,067)**	**$ (8,505)**	**$ (3,794)**

See accompanying notes to the financial statements

BALANCE SHEETS — ASSETS

	September 30, 2011	September 30, 2010
(Dollars in millions)		
Current Assets		
Cash and cash equivalents	$ 1,488	$ 1,161
Receivables:		
Foreign countries	669	714
U.S. government	154	173
Other	255	224
Receivables before allowances	1,078	1,111
Less: Allowance for doubtful accounts	37	32
Total receivables, net	1,041	1,079
Supplies, advances and prepayments	120	114
Total Current Assets	**2,649**	**2,354**
Property and Equipment, at Cost		
Buildings	24,263	23,822
Equipment	20,409	20,646
Land	2,952	2,974
Leasehold improvements	1,112	1,026
	48,736	48,468
Less: allowances for depreciation and amortization	29,023	28,333
	19,713	20,135
Construction in progress	624	1,460
Total Property and Equipment, Net	**20,337**	**21,595**
Other Assets - Principally Revenue Forgone Receivable	**427**	**377**
Total Assets	**$ 23,413**	**$ 24,326**

See accompanying notes to the financial statements

BALANCE SHEETS — LIABILITIES AND NET DEFICIENCY

	September 30, 2011	September 30, 2010
(Dollars in millions)		
Current Liabilities		
Compensation and benefits	$ 2,338	$ 2,924
Retiree health benefits	7	-
Workers' compensation	1,255	1,115
Payables and accrued expenses:		
Trade payables and accrued expenses	1,041	1,311
Foreign countries	652	586
U.S. government	119	136
Total payables and accrued expenses	1,812	2,033
Deferred revenue-prepaid postage	3,497	2,584
Customer deposit accounts	1,386	1,429
Outstanding postal money orders	688	639
Prepaid box rent and other deferred revenue	502	452
Debt	7,500	7,500
Total Current Liabilities	**18,985**	**18,676**
Noncurrent Liabilities		
Workers' compensation costs	13,887	11,474
Employees' accumulated leave	2,082	2,088
Deferred appropriation and other revenue	326	392
Long-term portion capital lease obligations	460	512
Deferred gains on sales of property	345	309
Contingent liabilities and other	768	248
Debt	5,500	4,500
Total Noncurrent Liabilities	**23,368**	**19,523**
Total Liabilities	**42,353**	**38,199**
Net Deficiency		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(22,072)	(17,005)
Total Net Deficiency	**(18,940)**	**(13,873)**
Total Liabilities and Net Deficiency	**$ 23,413**	**$ 24,326**

See accompanying notes to the financial statements

STATEMENT OF CHANGES IN NET DEFICIENCY

(Dollars in millions)		Capital Contributions of U.S. Government		Retained Deficit Since Reorganization		Total Net Deficiency
Balance, September 30, 2008	**$**	**3,034**	**$**	**(4,706)**	**$**	**(1,672)**
Additional capital contributions		53		-		53
Net loss		-		(3,794)		(3,794)
Balance, September 30, 2009	**$**	**3,087**	**$**	**(8,500)**	**$**	**(5,413)**
Additional capital contributions		45		-		45
Net loss		-		(8,505)		(8,505)
Balance, September 30, 2010	**$**	**3,132**	**$**	**(17,005)**	**$**	**(13,873)**
Additional capital contributions		0		-		0
Net loss		-		(5,067)		(5,067)
Balance, September 30, 2011	**$**	**3,132**	**$**	**(22,072)**	**$**	**(18,940)**

See accompanying notes to the financial statements

STATEMENTS OF CASH FLOWS

(Dollars in millions)	Years Ended September 30, 2011	2010	2009
Cash flows from operating activities:			
Net Loss	$ (5,067)	$ (8,505)	$ (3,794)
Adjustments to reconcile net loss to cash provided by operations:			
Depreciation and amortization	2,313	2,469	2,270
Gain on disposals of property and equipment and impairments, net	6	8	109
(Increase) decrease in other assets - primarily, appropriations receivable revenue forgone	(25)	10	52
Increase in noncurrent workers' compensation liability	2,413	2,410	2,061
(Decrease) increase in employees' accumulated leave	(6)	(8)	30
Decrease in noncurrent deferred appropriations and other revenue	(3)	(2)	(4)
Increase (decrease) in other noncurrent liabilities	520	(11)	(4)
Changes in current assets and liabilities:			
Receivables, net	53	(255)	(95)
Supplies, advances and prepayments	(6)	24	55
Compensation and benefits	(586)	158	71
Retiree health benefits	7	-	-
Workers' compensation	140	46	104
Payables and accrued expenses	(182)	182	123
Customers deposit accounts	(43)	50	(93)
Deferred revenue-prepaid postage	913	139	756
Outstanding postal money orders	49	(1)	(58)
Prepaid box rent and other deferred revenue	(2)	(6)	(10)
Net cash provided by (used in) operating activities	**494**	**(3,292)**	**1,573**
Cash flows from investing activities:			
Purchase of property and equipment	(1,190)	(1,393)	(1,839)
Proceeds from deferred building sale	48	19	6
Proceeds from sales of property and equipment	89	51	27
Net cash used in investing activities	**(1,053)**	**(1,323)**	**(1,806)**
Cash flows from financing activities:			
Issuance of notes payable	5,800	4,100	7,000
Payments on notes payable	(4,600)	(2,500)	(4,500)
Net change in revolving credit line	(200)	200	500
Payments on capital lease obligations, net	(51)	(50)	(46)
U.S. government appropriations - expensed	(63)	(63)	(64)
Net cash provided by financing activities	**886**	**1,687**	**2,890**
Net (decrease) increase in cash and cash equivalents	327	(2,928)	2,657
Cash and cash equivalents at beginning of year	1,161	4,089	1,432
Cash and cash equivalents at end of year	**$ 1,488**	**$ 1,161**	**$ 4,089**
Supplemental cash flow disclosures:			
Interest paid	$ 178	$ 161	$ 43

See accompanying notes to the financial statements

Notes to the Financial Statements

NOTE 1 — DESCRIPTION OF BUSINESS

NATURE OF OPERATIONS

The United States Postal Service (Postal Service) provides a variety of classes of mail service without undue discrimination among its many customers. This means that, within each class of mail, price does not unreasonably vary by customer for the service provided. This fulfills the Postal Service's legal mandate to offer universal service at a fair price. We have a very diverse customer base and are not dependent on a single customer or small group of customers. No single customer represents more than 1% of operating revenue. Operations are conducted primarily in the domestic market, with revenue from international mail service providers representing less than 4%.

Postal services are divided into two broad categories: Mailing Services and Shipping Services, which represent approximately 86% and 14% of revenue, respectively. Mailing Services revenue for the three years ended September 30, 2011, 2010, and 2009 was $57 million, $59 million, and $60 million, respectively. Shipping Services revenue for the three years ended September 30, 2011, 2010, and 2009 was $9 million, $8 million, and $8 million, respectively. First-Class Mail and Standard Mail account for about 94% of mail volume, and Priority Mail and Express Mail are significant products in the Shipping Services category. Markets for products and services include the financial services, communications, distribution, delivery, advertising, and other market sectors. Products and services are sold through over 32,000 Post Offices, stations and branches plus a large network of contract postal units, community post offices, village post offices and commercial outlets which sell stamps on our behalf.

More than 85% of career employees are covered by collective bargaining agreements and are primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU) and National Rural Letter Carriers' Association (NRLCA). By law, the Postal Service also consults with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity for nonbargaining unit employees in the field to participate directly in the planning, development, and implementation of programs and policies affecting managerial employees.

POSTAL REORGANIZATION

The Postal Service began operations on July 1, 1971, in accordance with the provisions of the *Postal Reorganization Act,* which established it as an "independent establishment of the executive branch of the Government of the United States." Governing decisions are made by a Board of Governors, which consists of independent members who are appointed by the President with the advice and consent of the Senate; the Board of Governors also includes the Postmaster General, who is appointed by the independent members of the Board of Governors and the Deputy Postmaster General, who is appointed by the independent Governors and the Postmaster General.

The U.S. Government's equity in the former Post Office Department (POD) became the Postal Service's beginning capital, with initial assets valued at original cost less accumulated depreciation. The transfer of assets from the POD, which included property, equipment, and cash, totaled $1.7 billion. Subsequent cash contributions and transfers of assets between 1972 and 1982 totaled approximately $1.3 billion. In 2010 and 2009, approximately 6,500 fuel efficient vehicles were contributed to the Postal Service under the provisions of the *American Recovery and Reinvestment Act*. The excess of the fair value of these vehicles over the fair value of the vehicles traded-in was recorded as additional non-cash capital contributions by the U.S. Government of $53 million in 2009 and $45 million in 2010. Total capital contributions of the U.S. Government are $3,132 million as of September 30, 2011. Although the U.S. Government remains responsible for the POD's liabilities, The *Balanced Budget Act of 1997* transferred the POD's workers' compensation liability to the Postal Service. The Postal Service has paid $599 million towards these liabilities of the POD as of September 30, 2011.

The *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435), made further revisions to the *Postal Reorganization Act*. The Postal Service's governing statute is codified in Title 39 of the United States Code. P.L. 109-435 created the Postal Regulatory Commission (PRC), endowing the PRC with regulatory and oversight obligations.

P.L. 109-435 also significantly altered some financial responsibilities, particularly with respect to the funding of Civil Service Retirement System (CSRS) benefits and retiree health benefits. Public Law 111-68, *Making appropriations for the Legislative Branch for the fiscal year-ending September 30, 2010, and for other purposes* amended P.L. 109-435 by changing the required Postal Service payments to the Postal Service Retiree Health Benefits Fund (PSRHBF) for the year ended September 30, 2009, from $5.4 billion to $1.4 billion. This law affected only the 2009 payment made in September 2009. It did not change the 2010 prefunding payment requirement of $5.5 billion which was made in September 2010, or subsequent required prefunding payments. On September 30, 2011, P.L. 112-33, the *Continuing Appropriations Act*, 2012, became law and deferred the PSRHBF prefunding payment of $5.5 billion due by September 30, 2011, to not later than October 4, 2011. P.L. 112-36, the *Continuing Appropriations Act*, 2012 extended that deferment of the 2011 PSRHBF payment to be due by November 18, 2011. As a result, the total required payment in 2012 is $11.1 billion: $5.5 due by November 18, 2011, plus the originally mandated 2012 payment of $5.6 billion due by September 30, 2012. To date, none of the law changes have addressed the original prefunding payment requirements for 2012 to 2016. See Note 7, *Health Benefit Programs*, for additional information.

NOTE 2 — LIQUIDITY MATTERS

SUMMARY OF PROJECTED CASH SHORTFALL

The Postal Service continues to suffer from a severe lack of liquidity caused by over $25 billion of net losses over the past five years including $21 billion of expenses for prefunding retiree health benefits. The Postal Service ended 2011 with $1.5 billion of total cash and $2.0 billion of remaining borrowing capacity on its $15 billion debt facility (See Note 4- *Debt,* in the Notes to the Financial Statements). The Postal Service's current financial projections indicate that it will not be able to make the required $5.5 billion prefunding payment for retiree health benefits currently due by November 18, 2011, or the required $5.6 billion prefunding payment for retiree health benefits that is due by September 30, 2012.

Additionally, even without the Postal Service making the $11.1 billion of scheduled PSRHBF payments in 2012, current projections indicate that it will have a precariously low level of cash and liquidity at September 30, 2012. As a result, the Postal Service would likely not be able to meet all of its financial obligations by October 2012 when it is required to make a payment of approximately $1.3 billion to the Department of Labor (DOL) for workers' compensation.

MAJOR FACTORS LEADING TO PROJECTED CASH SHORTFALL

The Postal Service had net losses of $5,067 million, $8,505 million, and $3,794 million for the years ended September 30, 2011, 2010, and 2009, respectively. Cash flow from operations for these years was $494 million in 2011 and $1,573 million in 2009. Cash used by operations was $3,292 million in 2010. However, without the enactment of P.L. 111-68 in 2009, which reduced the required PSRHBF prefunding payment from $5.4 billion to $1.4 billion, and P.L. 112-33 in 2011 which changed the date the $5.5 billion prefunding payment is due, the last time that the Postal Service would have had positive cash flow from operations would have been five years ago, in 2006.

Since 2006, the Postal Service has made approximately $38 billion of prefunding payments to the PSRHBF. The $38 billion is comprised of $21 billion of cash from Postal borrowings, and operations, plus $17 billion transferred from an overfunding of the CSRS account with OPM. In 2012, the Postal Service is required to make $11.1 billion of prefunding payments: the $5.5 billion payment originally due by September 30, 2011, but deferred until not later than November 18, 2011, plus the previously scheduled $5.6 billion payment due by September 30, 2012. To date, no changes have been made to the $33.9 billion prepayment schedule for 2012 to 2016 required by P.L. 109-435.

As noted in previous filings, Postal Service losses for the past three years are attributable to a combination of the declines in mail volume that began in 2008, the statutory and regulatory provisions that have the effect of limiting the Postal Service's ability to reduce costs and increase revenue, and the statutory requirement to prefund retiree health benefits. The declines in mail volume are primarily a result of the economic recession that began in December 2007 and the protracted economic weakness that has followed, along with the acceleration of a long-term trend of hard-copy correspondence and transactions migrating to electronic media. Revenue in 2011 was $65.7 billion, a $1.3 billion, or 2.0%, decrease from 2010 and almost $2.4 billion less than 2009.

Since peaking at 213.1 billion pieces in 2006, mail volume has dropped 45.2 billion pieces, or 21.2%, to 167.9 billion pieces in 2011, including reductions of 26 billion pieces in 2009, 6 billion pieces in 2010, and 3 billion pieces in 2011. The decline in First-Class Mail volume, by 25 billion pieces or 25% during that five-year period has had a particularly significant negative impact on the bottom line. To compensate for the loss of one piece of First-Class Mail, Standard Mail must increase by three pieces.

The volume that was lost to electronic alternatives, which was accelerated by the recession, is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses. Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the loss of First-Class Mail volume. In short, there currently is no foreseen revenue growth solution to the Postal Service's financial problem.

Forecasting in the current economic environment is subject to significant uncertainties. The operational plan for 2012 anticipates a reduction in mail volume of approximately 8 billion pieces from 2011 levels with an associated drop in revenue of approximately $2 billion.

Because of economic uncertainty and other currently unknown issues, it is possible that mail volume, and therefore revenue, could decrease at a rate greater than or less than this projection.

Compensation and benefits costs represent approximately 65% to 71% of total operating costs. However, when workers' compensation and retiree health benefits, including the legally mandated prefunding of the retiree health benefits, are added, total personnel costs increase to approximately 77% to 80%. Although many significant steps have been taken to decrease compensation and benefits costs in response to declining mail volume, many of these costs remain fixed and beyond the Postal Service's control due to its participation in federal programs. Contracts with postal unions are negotiated for a fixed period of time, usually three to five years. They cannot be modified during the contract period except by mutual consent. Retirement benefits are not determined by management but rather by the federal government, and healthcare benefit costs mandated by law or contract continue to rise well above the rate of inflation. In addition, the Postal Service's ability to adjust its workforce and network infrastructure is limited by contractual, statutory, regulatory and political obstacles.

FUTURE CASH DEMANDS

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and total outstanding debt of $15 billion. As of September 30, 2011, total outstanding debt is $13 billion, leaving $2 billion of borrowing capacity for future needs.

As noted above, the total 2012 required prefunding payment for retiree health benefits to the PSRHBF is $11.1 billion: $5.5 billion due by November 18, 2011, and $5.6 billion due by September 30, 2012. In addition, the Postal Service has a cash payment scheduled for October 2012 of approximately $1.3 billion to the DOL for the Postal Service's annual payment on its workers' compensation liability.

On June 24, 2011, as a result of the critically low liquidity level projected for the end of 2011 and all of 2012, the Postal Service suspended its employer's contributions to OPM for the defined-benefit portion of the FERS funding requirement. OPM has determined that the Postal Service had a FERS account surplus valued at approximately $6.9 billion as of September 30, 2009. OPM's latest calculation shows that the surplus has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made. The Postal Service continues to transmit to OPM the employees' contributions to the FERS defined benefit plan and also continues to transmit employer automatic and matching contributions and employee contributions to the Thrift Savings Plan.

The legally required Postal Service employer contribution to FERS is approximately $114 million per pay period (every two weeks). Suspension of payments, effective June 24, 2011, provided additional liquidity of $911 million through September 30, 2011. Based on advice received from the Office of Legal Counsel at the Department of Justice, in Quarter I, 2012, the Postal Service is expected to resume the regular biweekly payments for its FERS employer's contributions as well as remit all previously withheld payments, including the $911 million accrued at September 30, 2011.

In order to avoid default, statutory or regulatory adjustments to some, or all, of these obligations are necessary. The legal and/or regulatory consequences to the Postal Service of a default on the required PSRHBF contributions, or the workers' compensation payments to the U.S. Government, are unknown.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

The Postal Service has taken numerous actions to generate additional revenue and reduce operating expenses. Some of these are discussed below.

The Postal Service increased prices by an average of 1.7% for Mailing Services in April 2011 and by an average of 3.6% for Shipping Services in January 2011. The Mailing Services price increase was the first increase in almost two years. The Postal Service announced a 2.1% average price increase for Mailing Services and expects to implement additional moderate price increases for Shipping Services, both of which are expected to become effective in January 2012. At the same time, efforts have been made to increase revenues by implementing initiatives such as the expansion of simplified addressing for businesses, Priority Mail Regional Rate Boxes, Reply Rides Free, Every Door Direct Mail, and others. However, these new services are not expected to offset the decline in volume and revenue that is occurring in First-Class Mail.

As a result of management cost-control initiatives, work hours for 2011 were reduced by 34 million hours compared to 2010. This is in addition to reductions of 75 million and 115 million in fiscal years 2010 and 2009, respectively.

A new labor contract with the APWU, which affects approximately 205,000 employees, became effective May 23, 2011. The contract, which expires May 20, 2015, establishes pay levels for new career employees that are approximately 10% lower than the existing pay schedule, provides increased workforce flexibility, and will allow for increased use of noncareer employees. The Postal Service's contribution to employee health insurance premiums also will decrease. Provisions of the new agreement also include a 3.5% pay increase over the term of the contract, with no increases in 2011 and 2012.

These pay increases are in addition to periodic cost-of-living adjustments (COLAs), which are eliminated in 2011 and otherwise deferred until 2013.

To further reduce costs, the Postal Service continues implementation of an organizational redesign to realign administrative functions by reducing the number of Area and District Offices, and decreasing the number of authorized administrative, supervisory, and Postmaster positions by approximately 7,500. The Postal Service also suspended discretionary pay awards and has frozen officer and executive compensation. Additionally, the Postal Service continues to reduce the size of its workforce. Over the last five fiscal years, the Postal Service has decreased its workforce by approximately 140,000 career positions and saved nearly $14 billion in total costs.

As noted in previous filings, the Postal Service filed a request with the PRC on March 30, 2010, seeking an advisory opinion regarding the elimination of Congressionally mandated Saturday mail delivery to street addresses and associated changes. This is projected to save approximately $3 billion annually and remains a crucial component of the Postal Service's efforts to restructure its operations. The PRC responded to this request on March 24, 2011, and indicated, among other things, that they believe the Postal Service would save $1.7 billion annually from the elimination of Saturday delivery according to their calculations. At approximately the same time, the Government Accountability Office (GAO) issued its own report, *Ending Saturday Delivery Would Reduce Costs, But Comprehensive Restructuring is Also Needed,* on March 29, 2011. The GAO's position was that "when fully implemented, 5-day delivery would provide USPS with needed cost savings, although the extent of those savings is uncertain" and that "USPS's 5-day proposal should be considered in the context of other restructuring strategies both within and outside the delivery network." The Postal Service continues to pursue this matter.

In Quarter IV, 2011, the Postal Service announced plans to rationalize its mail processing, delivery, and retail networks, along with revisions to service standards. These programs consist of a variety of initiatives, such as:

- Streamlining the network of mail processing facilities.
- Modifying delivery routes, apart from five-day delivery.
- Studying underutilized Post Office locations for potential consolidation, closure, or conversion to a contract unit or a Village Post Office.
- Enhancing and expanding alternate access sites, including Village Post Offices and *http://www.usps.com*, and exploring franchising.
- Modifying service standards which will allow for longer operating windows and will reduce the requirements for equipment, facilities, and work hours.

These efforts are expected to help the Postal Service to reduce labor and benefits costs. Current Postal Service projections anticipate a decrease of approximately 100,000 employees over the next three years, with potential annual savings of approximately $6.5 billion. The service standard changes related to these plans require that the Postal Service request a non-binding advisory opinion from the PRC, which the Postal Service expects to file in December 2011. The PRC is allotted a minimum of 90 days from the date of filing to render a non-binding opinion.

As previously noted, the ability of the Postal Service to execute strategies to increase efficiency and reduce costs by adjusting its network, infrastructure, and workforce, and to retain and grow revenue, is currently constrained by contractual, statutory, regulatory, and political restrictions. As a result of these restrictions, Postal Service efforts to positively impact cash flow will not be sufficient, either individually or in the aggregate, to avoid a cash shortfall. Absent significant changes in the law, the Postal Service will default on the $5.5 billion prepayment due to the PSRHBF by November 18, 2011, and on the $5.6 billion prepayment due by September 30, 2012. Additionally, even if legislative changes defer or eliminate the $11.1 billion of prefunding payments currently due to the PSRHBF in 2012, the $15 billion debt ceiling will likely be reached in October 2012, thereby exhausting the Postal Service's external funding ability.

POSTAL LEGISLATIVE REQUESTS

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF prefunding payment schedule and FERS overfunding, the Postal Service will continue to face financial stability concerns. The Postal Service has taken, and continues to take, specific actions to address those elements under management's control. Despite these changes, the financial outlook continues to show the necessity of the following legislative changes, which we have already asked Congress to make:

- Resolve the retiree health benefits prefunding requirement which currently calls for $33.9 billion of additional prefunding payments from 2012 through 2016.
- Address the inequities in the current Civil Service Retirement System (CSRS) pension liability allocation methodology which has led to overfunding by the Postal Service by as much as $75 billion.
- Refund the FERS overfunding of $6.9 billion which according to OPM's latest calculation has grown to $10.9 billion as of September 30, 2010, the latest actual data available, and is projected to grow to $11.4 billion by September 30, 2011, assuming all employer contributions are made.
- Grant the Postal Service the authority to determine delivery frequency.

- Allow the Postal Service to offer non-postal products and services.
- Allow the Postal Service to restructure its healthcare systems.
- Develop a more streamlined governance model for the Postal Service that would allow for quicker pricing and product development decisions than currently exists within the regulatory framework.

Due to the gravity of the financial situation, more than a half-dozen different postal reform-related bills have been introduced in Congress in the past year, in addition to a plan proposed by the Administration. These plans address some of the short- and long-term issues that the Postal Service is facing.

There can be no assurance that any legislative changes will be made in time to impact 2012, or at all.

MITIGATING CIRCUMSTANCES

The Postal Service's status as an independent establishment of the executive branch which does not accept tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. Despite falling mail volume, the Postal Service is still widely recognized as providing an essential service to the American economy, and there are a wide variety of potential legislative remedies that could resolve the short-term liquidity concerns. Therefore, it is unlikely that, in the event of a cash shortfall, the federal government would cause or allow the Postal Service to significantly curtail or cease operations.

The Postal Service continues to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues the Postal Service faces and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2012, and beyond. However, there can be no assurances that the requested adjustments to the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

NOTE 3 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING AND USE OF ESTIMATES

The Postal Service conforms to accounting principles generally accepted in the United States (GAAP) and maintains its accounting records and prepares its financial statements on the accrual basis of accounting. Following these principles, estimates and assumptions are made that affect the amounts reported in the Financial Statements and disclosed in the Notes to the Financial Statements. Actual results may differ from those estimates.

These financial statements reflect the audited results of operations of the United States Postal Service for the years ended September 30, 2011, 2010 and 2009 and its financial position as of September 30, 2011 and 2010. All references to years, unless otherwise stated, refer to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to quarters within fiscal years 2011, 2010 and 2009. Subsequent events through November 15, 2011, the date that the financial statements were issued, have been evaluated.

SEGMENT INFORMATION

The Postal Service operates in one segment throughout the United States, its possessions and territories.

RECLASSIFICATIONS

Certain prior year amounts related to compensation and benefits as well as other operating expenses have been reclassified to conform to the current year's presentation. These reclassifications had no effect on previously reported operating losses and net losses.

RELATED PARTIES

The Postal Service has significant transactions with other U.S. Government agencies, as disclosed throughout this report. In addition to those amounts disclosed, deferred revenue of $39 million for 2011 and $71 million for 2010 related to government deposits is included in the Balance Sheets in "Customer Deposit Accounts."

CASH AND CASH EQUIVALENTS

Securities that mature within 90 days from the purchase date are deemed to be cash equivalents.

Included in "Cash and Cash Equivalents" are funds designated to be used for law enforcement purposes and consumer fraud prevention awareness. The amounts so designated at the end of 2011 and 2010 were $167 million and $170 million, respectively.

RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

Receivables are carried at book value. Billed receivables are generally liquidated within one year and do not have a stated interest rate.

Provision is made for doubtful accounts on outstanding receivables based on historical collection experience and an estimate of uncollectible accounts as of the reporting date. The following summarizes activity in the allowance for doubtful accounts:

Allowance for Doubtful Accounts

(Dollars in millions)		2011		2010		2009
Beginning Balance	$	32	$	29	$	41
Provision for Doubtful Accounts		13		11		6
Write-offs		8		8		18
September 30 Balance	**$**	**37**	**$**	**32**	**$**	**29**

SUPPLIES AND REPAIR PARTS

Supplies and repair parts consist of parts for mail processing equipment and are valued at average cost. Total supplies and repair parts were $93 million for 2011 and $91 million for 2010. A majority of motor vehicle spare parts are supplied through consignment agreements.

PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost, including interest paid on funds borrowed to pay for the construction of major capital additions.

Property and equipment are depreciated over estimated useful lives, which range from 3 to 40 years, except for buildings with historic status, which are depreciated over 75 years, using the straight-line method.

The depreciation and amortization of capital assets over the estimated useful lives, and the determination of salvage value, require management to make judgments about future events. Because capital assets are utilized over relatively long periods of time, periodic evaluations of whether adjustments to the estimated service lives and salvage values are necessary to ensure that these estimates properly match the economic useful lives of the asset. These evaluations may result in changes to the estimated lives and salvage values. These estimates affect the amount of depreciation expense recognized in a period and, ultimately, the gain or loss on disposal of the asset. Changes in the estimated lives of assets will result in an increase or decrease in the amount of depreciation and amortization recognized in future periods.

DEFERRED GAINS ON SALES OF PROPERTY

Deferred gains on sales of property are recognized in income and the sold assets removed from the accounting records when any lease-backs or other conditions requiring continued Postal Service involvement in the properties have expired.

Deferred gains recognized in income were $17 million in 2011, $18 million in 2010, and $11 million in 2009.

IMPAIRED ASSETS

Losses on long-lived assets are recorded when events or circumstances indicate that the assets might be impaired and there are indications that the fair value of the asset is less than the carrying value. To meet the Postal Service's universal service requirement, certain real estate and other assets are maintained which are underutilized. Such assets are not deemed impaired solely on the basis of volume of activity but, rather, are evaluated for impairment when no longer required to provide mailing services. When such a determination is made, impaired assets are written down to the lower of cost or fair value. Fair value is determined by comparison to independent appraisals for real property, adjusted for estimated selling costs. Due to the absence of a market for most types of mailing equipment, impaired equipment assets are assigned a fair value of zero.

In Quarter IV, 2011, the Postal Service announced plans to optimize its mail processing, delivery, and retail networks. See Note 2, Liquidity for details. As a result, an assessment was performed on both the real estate and equipment associated with the proposed optimization efforts to determine if any impairment should be recognized. As of September 30, 2011, final identification and approval for closure of specific assets has not been obtained. As a result, there are no related impairment charges in the current period. Once approval is obtained, determination of impairment, if any, will be made by management.

Impairment charges of $21 million, $26 million, and $71 million were recorded in 2011, 2010, and 2009 respectively, and are included in the Statement of Operations in "Other." The majority of the impairment charges in 2009 related to a project under development that was cancelled prior to implementation.

INTEREST CAPITALIZATION

Capitalized interest amounts were not material in 2011, 2010 and 2009.

REPAIRS AND MAINTENANCE

Repairs and maintenance are charged to expense as incurred. This expense amounted to $725 million in 2011, $676 million in 2010 and $703 million in 2009.

ASSETS HELD FOR SALE

Assets held for sale were immaterial to the total fixed assets balance in 2011 and 2010.

ASSET RETIREMENT OBLIGATIONS

A liability for the estimated costs of legally binding obligations to perform asset retirement activities is included in "Contingent Liabilities and Other" on the Balance Sheets.

AMORTIZATION OF LEASEHOLD IMPROVEMENTS

Leasehold improvements are amortized over the period of the lease or the useful life of the improvement, whichever is shorter.

Leasehold improvements that are placed in service after the start of the lease term are amortized over the shorter of the useful life of the asset or the remaining lease term, including renewal options that are reasonably assured to be executed.

FOREIGN CURRENCY TRANSLATION

Foreign currency risk exists related to settlements of receivables and payables with foreign postal administrations for international mail. The majority of international accounts are denominated in special drawing rights (SDRs). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, Japanese yen, British pound sterling and the U.S. dollar. Changes in the relative value of these currencies will increase or decrease the value of the settlement accounts and result in a gain or loss that is included in operating results. The impact of foreign currency translation on operating results was immaterial for 2011, 2010, and 2009.

OUTSTANDING POSTAL MONEY ORDERS

Postal money orders are sold at retail locations. A fee is charged at the time of sale. The fee is recognized as revenue at the time of sale. A current liability is recorded for money orders expected to be presented for payment.

REVENUE RECOGNITION/DEFERRED REVENUE-PREPAID POSTAGE

Deferred Revenue-Prepaid Postage is an estimate of postage that has been sold but not yet used by customers. Revenue is recognized only when services are rendered. Because payments for postage are collected in advance of services being performed, revenue is deferred and reflected in the Balance Sheets as *"Deferred Revenue–Prepaid Postage."* Two categories of postage sales account for the majority of deferred revenue–prepaid postage: stamp sales and metered postage.

Stamp sales in 2011 totaled $8.3 billion. Deferred revenue on stamp sales is estimated using statistical samples of stamped mail exiting our system across the country. The estimated stamp usage is subtracted from stamp sales with the difference representing our obligation to perform future services. We reduce that obligation by recognizing a provision for stamps sold that may never be used; either through loss, damage, or collecting activity, commonly referred to as the "breakage factor."

Metered postage is primarily used by businesses. Accordingly, the deferred revenue for meters is much smaller as a percentage of annual sales than for stamps, because business customers generally manage their cash flow much more closely and purchase postage only as needed. Deferred revenue related to meters is estimated by monitoring the actual usage of all postage meters that had postage added during the month preceding the financial measurement date. The information from the two most recent meter readings allows us to derive a deferral percentage, which is applied to all postage meter receipts for the month. Metered postage receipts in 2011 subject to deferral totaled $15.7 billion.

We also include in our estimate of deferred revenue–prepaid postage, an estimate for mail that is in transit within the postal system. We do this because the earnings process is not considered complete until mail is delivered to the customer.

In Quarter III, 2010, the Postal Service refined the stamp usage estimation methodology to reflect new information concerning the breakage factor. This resulted in an increase of deferred revenue-prepaid postage of $112 million, $103 million of which is attributable to changes that were not identifiable based on data previously available.

In Quarter I, 2011, the Postal Service enhanced the estimation technique employed to estimate deferred revenue prepaid postage for Forever Stamps. During that quarter, certain usage data indicated that a refinement of the estimation process for Forever Stamp usage was necessary. As a result of this enhancement, deferred revenue-prepaid postage was increased by $170 million.

These changes are both considered changes in accounting estimates under GAAP and, accordingly, the impact of the changes was reflected in the quarter that the estimate changes were made.

The chart below details our deferred revenue-prepaid postage by service category.

Deferred Revenue-Prepaid Postage

(Dollars in millions)	2011	2010
Forever Stamps	2,527	1,323
Non-Forever Stamps	246	488
Meters	459	506
Mail-In-Transit	247	254
Other, primarily precancelled stamps	18	13
Total Deferred Revenue-Prepaid Postage	**3,497**	**2,584**

ADVERTISING EXPENSES

Advertising costs are expensed as incurred and are included in other operating expenses. Advertising expenses were $147 million in 2011 and 2010, and $105 million in 2009.

COMPENSATION AND BENEFITS

Compensation and benefits payable consists of the salaries and benefits owed to current and former employees, including the amounts employees have earned but have not yet been paid, unemployment, and health benefit costs.

CONTINGENT LIABILITIES

The Postal Service is involved in various legal proceedings and contingencies. A liability is recorded based on our estimate of the probable cost of the resolution of a contingency. The actual resolution of these contingencies may differ from our estimates. If a contingency is settled for an amount greater than the estimate, a future charge to income would result. Likewise, if a contingency is settled for an amount that is less than the estimate, a future credit to income would result.

The events that may impact contingent liabilities are often unique and generally are not predictable. At the time a contingency is identified, all relevant facts are considered as part of our evaluation. A liability is recorded for a loss when the loss is probable of occurring and reasonably estimable. Events may arise that were not anticipated and the outcome of a contingency may result in a loss to the Postal Service that differs from the previously estimated liability. These factors could result in a material difference between estimated and actual operating results. See Note 6, *Contingent Liabilities* for additional information.

RETIREE BENEFITS

Employees are eligible to participate in the federal government sponsored pension and retiree health benefits programs. The Postal Service is required to provide funding for these plans as determined by the administrator of the plans, the OPM. The Postal Service cannot direct the costs, benefits, or funding requirements of the plans. Accordingly, the plans are accounted for using multiemployer plan accounting rules and expense is recorded in the period the contribution is due and payable. These amounts can fluctuate significantly from year to year if changes in funding requirements are made. See Note 7, *Health Benefit Programs*, and Note 8, *Retirement Programs*, for additional information.

WORKERS' COMPENSATION

Workers' compensation expenses are incurred under a program administered by the DOL and include employees' medical expenses, compensation for wages lost, and DOL administrative fees. See Note 9, *Workers' Compensation*, for additional information.

EMPLOYEES' ACCUMULATED LEAVE

Employees earn annual leave based on their number of creditable years of service. The Postal Service advances annual leave to employees at the beginning of each calendar year for the value of leave they will earn for the year. Leave taken by employees before it is earned is considered an advance. Employees' accumulated leave represents leave earned as of the balance sheet date and is recorded net of advances.

REVENUE FORGONE APPROPRIATION

Revenue forgone is an appropriation from Congress which covers the cost of providing mailing services to certain groups at no cost or at reduced rates. The costs incurred for this service are estimated by the Postal Service and submitted to Congress annually. Congress subsequently approves or alters the amount and funds the necessary appropriation. See Note 11, *Revenue Forgone*, for additional information.

EMERGENCY PREPAREDNESS APPROPRIATION

Emergency preparedness appropriations were received from Congress to help pay the costs of keeping the mail, postal employees and postal customers safe, and are restricted for such use. These funds were accounted for as deferred revenue upon receipt and were generally utilized to procure capital equipment. Revenue for emergency preparedness appropriations is recognized when depreciation expense for the purchased equipment is recorded. The emergency preparedness appropriations revenue recognized during the years ended September 30, 2011, and 2010 was $63 million, and for the year ended September 30, 2009, was $64 million.

Deferred revenue at September 30 related to emergency preparedness appropriations was $360 million in 2011 and $423 million in 2010. The current portion is included in “Prepaid box rent and other deferred revenue,” and the noncurrent portion is included in “Deferred appropriation and other revenue” on the Balance Sheets.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-09, Compensation-Retirement Benefits-Multiemployer Plans (Accounting Standards Codification 715-80), which outlines new required disclosures about an organization’s involvement in those plans. The amendments are effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. Retrospective application of the new disclosures will also be required. We will be adopting the new rules beginning with the year ended September 30, 2012.

Other new pronouncements issued but not effective until after September 30, 2011, are not expected to have a significant effect on our consolidated financial position or results of operations.

NOTE 4 — DEBT

DEBT LIMITS

Under the *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435, the Postal Service can issue debt obligations. The Postal Service is limited by statute to net annual debt increases of $3 billion. Total debt cannot exceed $15 billion.

NOTE PURCHASE AGREEMENTS

The Postal Service has two revolving credit line facilities with the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury, both of which were renewed until May 2012. One, a short-term credit line, enables it to draw up to $3,400 million with two days prior notice. Borrowings under this credit line are typically on an overnight basis, but can have a maximum term of up to one year. The second credit line, which only allows for borrowings on an overnight basis, enables borrowings of up to $600 million on the same business day that funds are requested. The interest rates for borrowings under these credit facilities are determined by the Treasury each business day.

In addition, under the provisions of a Note Purchase Agreement with the FFB, the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. The Note Purchase Agreement, renewable annually, was extended to September 30, 2012.

These credit line facilities and note arrangements provide the flexibility to borrow short- or long-term, using fixed- or floating-rate notes. Fixed-rate notes can be either callable or non-callable.

Debt, all of which is unsecured and not subject to sinking fund requirements, can be repaid at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment. Debt as of September 30, 2011, and 2010, is as follows:

Indebtedness to Federal Financing Bank
(Dollars in millions)

Maturity	Debt Type	September 30, 2011 Balance	September 30, 2011 Rate	September 30, 2010 Balance	September 30, 2010 Rate
Fixed rate notes - short term					
December 30, 2010	Fixed rate-payable at maturity	$ —	— %	$ 1,900	0.282%
October 20, 2011	Fixed rate-payable at maturity	1,300	0.338	—	—
November 17, 2011	Fixed rate-payable at maturity	1,200	0.201	—	—
Fixed rate notes - long term					
January 31, 2014	Fixed rate-payable at maturity	300	2.035	300	2.035
May 2, 2016	Fixed rate-payable at maturity	300	2.844	300	2.844
November 15, 2018	Fixed rate-payable at maturity	500	3.048	500	3.048
February 15, 2019	Fixed rate-payable at maturity	700	3.296	700	3.296
May 15, 2019	Fixed rate-payable at maturity	1,000	3.704	1,000	3.704
May 15, 2019	Fixed rate-payable at maturity	500	3.513	500	3.513
August 16, 2021	Fixed rate-payable at maturity	1,000	2.066	—	—
May 17, 2038	Fixed rate-payable at maturity	200	3.770	200	3.770
February 15, 2039	Fixed rate-payable at maturity	1,000	3.790	1,000	3.790
Floating rate notes and revolving credit line - short term					
July 15, 2011	Floating rate	—	—	1,000	0.206
July 15, 2011	Floating rate	—	—	700	0.206
July 15, 2011	Floating rate	—	—	500	0.206
December 15, 2011	Floating rate	700	0.135	—	—
June 15, 2012	Floating rate[1]	300	0.135	—	—
June 15, 2012	Floating rate[1]	800	0.135	—	—
	Short-term revolving credit line	3,200	0.125	3,400	0.206
Total debt		**$ 13,000**		**$ 12,000**	
Less: Current portion of debt		**7,500**		**7,500**	
Long-term portion of debt		**$ 5,500**		**$ 4,500**	

[1] Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on December 15, 2011, and March 15, 2012.

At September 30, 2011, scheduled repayments of debt principal, exclusive of capital leases, is as follows:

Scheduled Debt Principal Repayments

(Dollars in millions)

2012		**7,500**
2013		**-**
2014		**300**
2015		**-**
2016		**300**
After 2016		**4,900**
Total Debt	**$**	**13,000**

NOTE 5 — LEASES AND OTHER COMMITMENTS

LEASES

Future minimum lease payments for all noncancelable leases as of September 30, 2011 are as follows:

Lease Obligations

(Dollars in millions)		Operating		Capital
2012	$	739	$	103
2013		696		96
2014		638		91
2015		579		89
2016		510		86
After 2016		4,139		287
Total Lease Obligations	**$**	**7,301**	**$**	**752**
Less: Interest				234
Total Capital Lease Obligations				**518**
Less: Current Portion of Capital Lease Obligations				58
Noncurrent portion of capital lease obligations			**$**	**460**

Leases generally have renewal options for periods ranging from 3 to 20 years. Certain noncancelable real estate leases have purchase options at prices specified in the leases.

Capital leases included in buildings at September 30 were $898 million in 2011 and $920 million in 2010. Total accumulated amortization was $531 million and $510 million at September 30, 2011, and 2010, respectively. Amortization expense for assets recorded as capital leases is included in "Other" in the Statements of Operations.

Rental expense for the years ended September 30 is summarized as follows:

Rental Expense

(Dollars in millions)		2011		2010		2009
Noncancelable real estate leases	$	956	$	964	$	992
GSA facilities leases*		42		44		43
Equipment and other short-term rentals		161		153		155
Total Rental Expense	**$**	**1,159**	**$**	**1,161**	**$**	**1,190**

*General Services Administration; leases subject to 120-day cancellation notice.

CAPITAL COMMITMENTS

At September 30, 2011, financial commitments for approved capital projects in progress are as follows:

Capital Commitments

(Dollars in millions)		**2011**		**2010**
Mail Processing Equipment	$	481	$	772
Building Improvements, Construction, and Building Purchase		320		430
Postal Support Equipment		75		73
Retail Equipment		-		33
Vehicles		5		7
Total Capital Commitments	**$**	**881**	**$**	**1,315**

NOTE 6 — CONTINGENT LIABILITIES

Contingent liabilities consist mainly of claims and lawsuits resulting from labor, employment, environmental matters, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims, and traffic accidents.

Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of potential resolution is reasonably estimable, a liability for the loss is recorded. Each quarter, any prior claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. This reevaluation of cases resulted in an increase to the liability of $448 million and $13 million for the year ended September 30, 2011, and 2010, respectively. The table summarizes contingent liabilities provided for in the financial statements at September 30, 2011, and 2010.

Contingent Liabilities

(Dollars in millions)		**2011**		**2010**
Labor- Employment	$	662	$	238
Environmental		48		40
Tort		39		35
Contractual		13		1
Total Contingent Liabilities	**$**	**762**	**$**	**314**

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Potter (first instituted in 2006), with the class consisting of all permanent rehabilitation employees and limited duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to the present. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter.

Based on currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability is $72 million at September 30, 2011, and $114 million as of September 30, 2010, and is included on the Balance Sheets in “Trade payables and accrued expenses”. The long-term portion of this liability at September 30, 2011, was $690 million and $200 million at September 30, 2010. These amounts are accrued in “Contingent liabilities and other” on the Balance Sheets.

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from $800 million to $1,100 million at September 30, 2011. No provisions for these possible losses are accrued or included in the financial statements.

NOTE 7 — HEALTH BENEFIT PROGRAMS

CURRENT EMPLOYEES

Substantially all career employees are covered by the Federal Employees’ Health Benefits Program (FEHBP). OPM administers the program and allocates the cost of the program to the various participating government agency employers. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan and, therefore, accounts for program expenses using multiemployer plan accounting rules.

The Postal Service cost is based upon the weighted-average premium cost of the various employee coverage choices and the specific coverage choices made by employees. Employees paid approximately 21% of the premium costs in 2011, 20% in 2010 and 19% in 2009. Postal Service employee healthcare expense was $5,222 million in 2011, $5,141 million in 2010, and $5,294 million in 2009.

RETIREES

Employees who participate in the FEHBP for the five years immediately preceding their retirement may participate in the FEHBP during their retirement. The Postal Service is required to pay the employer’s share of health insurance premiums for all retired postal employees and their survivors who participate in the FEHBP and who retire on or after July 1, 1971. Costs attributable to federal civil service before that date are not included.

In 2006, P.L. 109-435 created the PSRHBF, which is held by the U.S. Treasury and controlled by OPM, but funded by the Postal Service. P.L. 109-435 established a ten-year schedule of Postal Service prefunding payments into the fund that ranged between $5.4 and $5.8 billion per year. However, the 2009 scheduled prefunding payment was decreased from $5.4 billion to $1.4 billion due to the enactment of P.L. 111-68. This law affected only the 2009 prefunding payment and did not change the prefunding payment requirements for subsequent years. The prefunding schedule was further changed on September 30, 2011, when H.R. 2017, the *Continuing Appropriations Act, 2012*, deferred the scheduled 2011 PSRHBF prefunding payment of $5.5 billion to be due by October 4, 2011. P.L. 112-36, the *Continuing Appropriations Act, 2012* extended that deferment to not later than November 18, 2011. As a result, the total required 2012 prefunding payments are $11.1 billion: $5.5 due by November 18, 2011, plus $5.6 billion due by September 30, 2012. To date, none of the law changes have addressed the original prefunding payment requirements for 2012 to 2016.

Although P.L. 109-435 dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could be changed at any time with enactment of a new law or an amendment of existing law. At September 30, 2011, scheduled prefunding payments to the PSRHBF are:

PSRHBF Commitment (Dollars in millions)		**P.L. 109-435 Requirement**
2012		11,100
2013		5,600
2014		5,700
2015		5,700
2016		5,800
Total PSRHBF Commitment	**$**	**33,900**

These annual prefunding payments are in addition to the regularly allocated cost of premiums for current retirees, which continue to be payable through 2016. The law requires that, not later than 2017, OPM will perform an actuarial valuation to determine if additional payments into the PSRHBF are required. If required, OPM will design an amortization schedule to fully fund any remaining liability by 2056. Starting in 2017, the Postal Service's share of the health insurance premiums for current and future Postal Service retirees will be paid from the PSRHBF. Beginning in 2017, the Postal Service will also fund the actuarially determined normal cost. The Postal Service did not make any prefunding payments in 2011, but paid $5.5 billion and $1.4 billion into the fund in 2010 and 2009, respectively. At September 30, 2011, the balance in the fund was $44.1 billion.

Total retiree health benefits expenses were $2,441 million in 2011, $7,747 million in 2010 and $3,390 million in 2009. Components of retiree health benefits expense for the three years ended September 30, 2011, are as follows:

Retiree Health Benefits (Dollars in millions)		**2011**		**2010**		**2009**
Retiree Health Benefits Premiums	$	2,441	$	2,247	$	1,990
P.L. 109-435 Payment to PSRHBF		-		5,500		1,400
Total Retiree Health Benefits	**$**	**2,441**	**$**	**7,747**	**$**	**3,390**

Because the amounts to be paid into the PSRHBF are set by legislation, our retiree health expense may not represent the full cost of the benefits earned by USPS employees. These costs are reflected as "Retiree health benefits" in the Statements of Operations.

NOTE 8 — RETIREMENT PROGRAMS

PENSION PROGRAMS

Employees participate in one of three pension programs based on the starting date of employment with the federal government. Employee and employer contributions are made to the Civil Service Retirement System (CSRS), the Dual Civil Service Retirement System/Social Security (Dual CSRS), or the Federal Employees Retirement System (FERS), all of which are administered by the OPM. Employees may also participate in the Thrift Savings Plan (TSP), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board.

<u>CSRS</u>
Officers and career employees hired prior to January 1, 1984, are covered by the CSRS, which provides a basic annuity toward which the Postal Service and the employee contribute at rates prescribed by law. Effective October 2006, P.L. 109-435 suspends the employer obligation to make contributions for CSRS employees' retirement until 2017. At that time, OPM will perform an actuarial valuation to determine whether additional payments are necessary. The Postal Service does not match TSP contributions for employees participating in CSRS.

<u>Dual CSRS</u>
Employees with prior U.S. Government service who were rehired between January 1, 1984, and January 1, 1987, are covered by Dual CSRS, which consists of a basic annuity and Social Security. The Postal Service and the employee contribute to Social Security and the basic annuity at rates prescribed by law. The Postal Service does not match TSP contributions for employees participating in Dual CSRS.

<u>FERS</u>
Effective January 1, 1987, officers and career employees hired since December 31, 1983, are covered by the *Federal Employees Retirement System Act of 1986*, except for those covered by Dual CSRS. Also included are employees formerly covered by CSRS who elected in either 1987, 1988, or 1998 to participate in FERS.

FERS consists of Social Security, a basic annuity plan, and TSP. The Postal Service and the employee contribute to Social Security and the basic annuity plan at the rates prescribed by law. The Postal Service is required to contribute to TSP a minimum of 1% per year of the basic pay of employees covered by this system. It is also required to match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of an employee's contribution of between 3% and 5% of basic pay.

EMPLOYEE / EMPLOYER CONTRIBUTIONS

During fiscal years 2009 and 2010, employer contributions, as a percentage of employee basic pay were 11.2% for FERS and zero for CSRS and Dual CSRS. During fiscal year 2011, employer contributions, as a percentage of employee basic pay were 11.7% for FERS and zero for CSRS and Dual CSRS. Beginning on June 24, 2011 the Postal Service suspended payment of the employer contribution to FERS. It continued to accrue a liability to FERS for unpaid amounts, pending final resolution of the funding status of FERS. The total amount accrued and unpaid of $911 million is included in Compensation and Benefits Payable. See Note 2- *Liquidity Matters*, for further discussion of the suspension of FERS employer contributions in 2011.

Employer contributions, as a percentage of employee basic pay for FERS will increase to 11.9% in 2012. Employee contributions for the past three years, as a percentage of employee basic pay were 7.0% for CSRS and 0.8% for Dual CSRS and FERS. The number of employees enrolled in each of the retirement plans at the end of 2011, 2010, and 2009 is as follows.

Retirement Enrollment by Program (Actual numbers)	2011	2010	2009
CSRS	79,014	90,480	110,024
Dual CSRS	4,551	5,206	5,947
FERS	473,686	488,222	507,157
Total Enrollment	**557,251**	**583,908**	**623,128**

EXPENSE COMPONENTS

The following table lists the components of total retirement expenses included in "Compensation and Benefits" expense in the Statements of Operations for 2011, 2010, and 2009.

Retirement Expense (Dollars in millions)	2011	2010	2009
FERS	$ 2,983	$ 2,904	$ 2,962
Social Security	1,856	1,856	1,882
FERS Thrift Savings Plan	1,040	1,049	1,073
Total Retirement Expense	**$ 5,879**	**$ 5,809**	**$ 5,917**

Employer cash contributions to retirement plans were $3,214 million in 2011, $3,944 million in 2010, and $4,024 million in 2009. These amounts do not include Social Security contributions.

NOTE 9 — WORKERS' COMPENSATION

Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the DOL's Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. However, the Postal Service annually reimburses the DOL for all workers' compensation benefits paid to or on behalf of employees, and pays an administrative fee to DOL.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon currently open claims and past claim payment experience.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The liability for claims arising more than 10 years ago is determined by an independent actuary. The FECA benefit structure is often superior to benefits available under normal federal retirement, and these more lucrative payments will, in some cases, be for the rest of the lives of the claimants.

The liability for estimated future workers' compensation payments is recorded at its present value. To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at the balance sheet date in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The inflation and discount rates used to estimate the liability at September 30, 2011, 2010, and 2009 are shown in the following table:

Workers' Compensation Liability	September 30,		
Inflation and Discount Rates	**2011**	**2010**	**2009**
Compensation Claims Liability			
Discount Rate	2.3%	2.9%	4.9%
Wage inflation	2.9%	2.9%	3.2%
Medical Claims Liability			
Discount Rate	2.4%	3.0%	4.4%
Medical inflation	8.6%	7.4%	3.8%

In 2010, the Postal Service began to use the average rate of medical inflation experienced by its workers' compensation claimants over the past five years as an estimate for future medical inflation. Prior to 2010, forecasted medical inflation rates published by an independent source had been used. During 2010, the Postal Service determined that its own history served as a better indicator of future costs and revised the estimation accordingly. The impact of this change was to increase the liability by $50 million and was accounted for as a change in accounting estimate.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the September 30, 2011 liability and 2011 expense by approximately $1,500 million. A decrease of 1% in the discount rate would increase the September 30, 2011 liability and 2011 expense by approximately $1,900 million.

At September 30, 2011, the present value of the liability for future workers' compensation payments was $15,142 million, compared to $12,589 million at September 30, 2010, an increase of $2,553 million. The current portion of this liability was $1,255 million at September 30, 2011, and $1,115 million at September 30, 2010. These amounts are accrued under "Workers' compensation" on the Balance Sheets.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases and the progression of existing cases. The impact of the changes in discount and inflation rates accounted for $978 million and $2,017 million of the 2011 and 2010 expense, respectively.

In 2011, workers' compensation expense was $3,672 million compared to $3,566 million in 2010 and $2,223 million in 2009. The components of workers' compensation expense are as follows:

Workers' Compensation Expense	**Years Ended September 30,**		
(Dollars in millions)	**2011**	**2010**	**2009**
Impact of discount & inflation rate changes	$ 978	$ 2,017	$ 718
Actuarial revaluation of existing cases	1,264	483	625
Subtotal	**2,242**	**2,500**	**1,343**
Costs of new cases	1,367	1,009	825
Administrative fee	63	57	55
Total Workers' Compensation Expense	**$ 3,672**	**$ 3,566**	**$ 2,223**

NOTE 10 — FAIR VALUE MEASUREMENT

The Postal Service assumes that the carrying value of current assets and current liabilities approximates fair values. The Postal Service also has noncurrent financial instruments, such as the long-term portion of debt (see Note 4 - *Debt*) and long-term receivables (see Note 11 - *Revenue Forgone*), that must be measured for disclosure purposes on a recurring basis under authoritative accounting literature as promulgated by the Financial Accounting Standards Board. The Postal Service also applies these requirements to various non-recurring measurements of financial and non-financial assets and liabilities, such as the impairment of property and equipment. Measurement of assets and liabilities at fair value is performed using inputs from the following three levels of the fair value hierarchy as defined in the authoritative literature:

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.
- Level 3 inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

Because no active market exists for the debt with the FFB, the fair value of the noncurrent portion of these notes has been estimated using prices provided by the FFB, a level 3 input.

The fair value of revenue forgone has been estimated using the income method and discount rates on similar assets, such as noncurrent U.S. Treasury securities that have a similar maturity, a level 2 input.

The carrying values and the fair values of noncurrent assets and liabilities that qualify as financial instruments in accordance with the accounting literature are in the table below:

Fair Value of Long-Term Financial Assets and Liabilities

(Dollars in millions)

	September 30, 2011		September 30, 2010	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Revenue Forgone	$ 393	$ 540	$ 360	$ 490
Total Long-Term Financial Assets	**393**	**540**	**360**	**490**
Debt	5,500	6,148	4,500	4,815
Total Long-Term Financial Liabilities	**$ 5,500**	**$ 6,148**	**$ 4,500**	**$ 4,815**

The above table is presented for disclosure purposes only. The Postal Service has not recorded a charge or credit to its operations for the differences between carrying and fair values of the above assets and liabilities.

The reconciliation of the fair values of the long-term portion of debt calculated using level 3 inputs is below:

Reconciliation of Fair Value of Level 3 Instruments

(Dollars in millions)

Balance at September 30, 2010	$ 4,815
New Indebtedness	1,000
Unrecognized Loss	333
Balance at September 30, 2011	**$ 6,148**

For the year ended September 30, 2011, there were no significant transfers between Level 1 and Level 2 assets or liabilities.

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of an asset, and recorded at fair value only when impairment is recognized. Impairment analyses of property and equipment were performed in each quarter of 2011 and 2010 and, based on those analyses, impairment charges of $21 million, $26 million, and $71 million were recorded in 2011, 2010, and 2009 respectively. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed level 2 inputs as defined above. See section on impaired assets in Note 3, *Significant Accounting Policies.*

NOTE 11 — REVENUE FORGONE

Revenue forgone is an appropriation that compensates the Postal Service for the cost of services that it is required to perform at no cost or reduced cost to certain groups. Congress appropriates funds to reimburse the Postal Service for the revenue that has been forgone in providing these services.

The lost revenue associated with the services that will be provided during a given year is estimated and forwarded to Congress with a funding request. At the end of the year, the actual value of services provided is reconciled with this funding request. If the actual services provided differs from that underlying the initial funding request, the Postal Service will request additional funding or return any excess funding through a reduction to the next revenue forgone funding request.

During 2011, the Postal Service recognized $119 million in revenue, including $24 million of imputed interest, from the appropriations, compared to $113 million, including $24 million of imputed interest in 2010. In 2009, $71 million was recognized in revenue, which included $24 million of imputed interest. The revenue forgone receivable is included in the Balance Sheets as “Receivables: U.S. Government.”

The Revenue Forgone Reform Act of 1993 authorized Congress to make 42 annual payments of $29 million each, beginning in 1994 and continuing through 2035, to reimburse the Postal Service for certain services performed or revenue forgone from 1991 through 1998. The payments authorized by the *Revenue Forgone Reform Act of 1993* totaled $1,218 million, which had a present value calculated at a 7% discount rate of approximately $390 million. The $390 million was recognized as revenue during fiscal years 1991 through 1998. The discounted present value of the remaining future payment for the years ended September 30 was $351 million in 2011 and $339 million in 2010.

The total receivable for revenue forgone was $467 million in 2011 of which $74 million was classified as current assets. In 2010, the total receivable was $449 million and the current portion was $89 million.

NOTE 12 — SELECTED QUARTERLY FINANCIAL DATA

2011 (Dollars in millions, unaudited)	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Operating revenue	$ 17,877 b	$ 16,234	$ 15,766	$ 15,834
Total operating expenses	18,167	18,426	18,831	15,210 a
(Loss) Income from operations	(290)	(2,192)	(3,065)	624
Interest income (expense) - net	(39)	(36)	(35)	(34)
Net (Loss) Income	**$ (329)**	**$ (2,228)**	**$ (3,100)**	**$ 590**

2010 (Dollars in millions, unaudited)	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Operating revenue	$ 18,355	$ 16,697	$ 16,045 c	$ 15,955
Total operating expenses	18,618	18,250	19,510 d	19,048
(Loss) from operations	(263)	(1,553)	(3,465)	(3,093)
Interest income (expense) - net	(34)	(31)	(33)	(33)
Net (Loss)	**$ (297)**	**$ (1,584)**	**$ (3,498)**	**$ (3,126)**

2009 (Dollars in millions, unaudited)	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Operating revenue	$ 19,095	$ 16,938	$ 16,339	$ 15,718 f
Total operating expenses	19,475	18,840	18,721 e	14,794 g
(Loss) Income from operations	(380)	(1,902)	(2,382)	924
Interest income (expense) - net	(4)	(3)	(19)	(28)
Net (Loss) Income	**$ (384)**	**$ (1,905)**	**$ (2,401)**	**$ 896**

a - Includes the impact of the $5.5 billion reduction in the PSRHBF contribution due to P.L. 112-33.

b - Includes the impact of the $170 million increase to the stamp portion of the deferred revenue-prepaid postage, due to a change in estimate.

c - Includes the impact of the $103 million increase to the stamp portion of the deferred revenue-prepaid postage, due to a change in estimate.

d - Includes the impact of the $1,656 million increase in workers' compensation expense, due to changes in discount and inflation rates.

e - Includes the impact of the $807 million increase in workers' compensation expense, due to changes in discount and inflation rates.

f - Includes the impact of the $655 million increase to the stamp portion of the deferred revenue-prepaid postage, due to a change in estimate.

g - Includes the impact of the $4 billion reduction in the PSRHBF contribution due to P.L. 111-68.

Operating Statistics

Mailing and Shipping Statistics	2011	2010	2009	2008	2007
(In millions of units indicated, unaudited)					
Mailing Services					
First-Class Mail					
Revenue	$ 32,179	$ 34,153	$ 35,883	$ 38,179	$ 38,404
Pieces, Number	73,521	78,514	83,766	91,697	96,297
Weight, Pounds	3,726	3,699	3,683	4,165	4,401
Standard Mail					
Revenue	$ 17,826	$ 17,331	$ 17,345	$ 20,586	$ 20,779
Pieces, Number	84,692	82,525	82,448	99,084	103,516
Weight, Pounds	9,092	9,346	9,279	11,017	11,820
Periodicals					
Revenue	$ 1,821	$ 1,879	$ 2,038	$ 2,295	$ 2,188
Pieces, Number	7,077	7,269	7,901	8,605	8,796
Weight, Pounds	2,725	2,778	3,018	3,677	3,896
Package Services					
Revenue	$ 1,606	$ 1,544	$ 1,684	$ 1,845	$ 1,812
Pieces, Number	675	657	731	846	915
Weight, Pounds	1,784	1,742	1,873	2,155	2,297
U.S. Postal Service					
Pieces, Number	434	438	455	824	1,008
Weight, Pounds	149	133	126	149	141
Free Matter for the Blind					
Pieces, Number	62	68	62	72	72
Weight, Pounds	30	32	30	34	34
Total Mailing Services Mail					
Revenue	**$ 53,432**	**$ 54,907**	**$ 56,950**	**$ 62,905**	**$ 63,183**
Pieces, Number	**166,461**	**169,471**	**175,363**	**201,128**	**210,604**
Weight, Pounds	**17,506**	**17,730**	**18,009**	**21,197**	**22,589**
Ancillary & Special Services					
Registered Mail					
Revenue	$ 45	$ 48	$ 50	$ 57	$ 53
Number of articles	3	3	3	4	4
Certified Mail					
Revenue	$ 709	$ 791	$ 731	$ 718	$ 698
Number of articles	251	283	267	269	280
Insurance					
Revenue	$ 117	$ 128	$ 129	$ 145	$ 157
Number of articles	35	40	44	52	57
Delivery Receipt Services					
Revenue	$ 729	$ 788	$ 717	$ 704	$ 640
Number of articles	1,678	1,595	1,284	1,192	1,098
Money Orders					
Revenue	$ 172	$ 182	$ 190	$ 205	$ 211
Face value of issues (non-add)	$ 22,382	$ 22,792	$ 23,839	$ 25,709	$ 27,194
Number of articles	116	123	135	149	163
Box Rent Revenue & Caller Services	$ 911	$ 928	$ 929	$ 897	$ 837
Stamped Envelope and Card Revenue	$ 12	$ 15	$ 17	$ 24	$ 17
Other Mailing Services Revenue*	$ 590	$ 801	$ 123	$ 895	$ 1,108
Total Ancillary & Special Services Revenue	**$ 3,285**	**$ 3,681**	**$ 2,886**	**$ 3,645**	**$ 3,721**
Total Mailing Services Revenue	**$ 56,717**	**$ 58,588**	**$ 59,836**	**$ 66,550**	**$ 66,904**

* Includes a $298 million, $103 million, a $655 million, and a $230 million increase to the deferred revenue-prepaid postage liability in 2011, 2010, 2009, and 2008, respectively. These amounts, which primarily include changes in estimates, are recorded in the other mailing services revenue category so as to not distort the period over period volume statistics (Pieces, Number) by service line.

Note: In 2011, the PRC approved a new methodology for allocating revenue across products. This new methodology was applied to revenue and volume data relating to 2011 and 2010. These reclassifications did not impact total mail revenue and volume for 2009. The new methodology does not change total revenue.

Operating Statistics

Mailing and Shipping Statistics	2011	2010	2009	2008	2007
(In millions of units indicated, unaudited)					
Shipping Services					
Revenue	$ 8,831	$ 8,317	$ 8,112	$ 8,355	$ 7,852
Pieces, Number	1,473	1,389	1,381	1,575	1,630
Weight, Pounds	3,354	2,958	2,775	3,040	3,054
Shipping Services					
Ancillary & Special Services Revenue	$ 163	$ 147	$ 142	$ 27	$ 23
Total Shipping Services Revenue	$ **8,994**	**$ 8,464**	**$ 8,254**	**$ 8,382**	**$ 7,875**
Postal Service Totals					
Revenue	$ 62,263	$ 63,224	$ 65,062	$ 71,261	$ 71,035
Pieces, Number	167,934	170,860	176,744	202,703	212,234
Weight, Pounds	20,860	20,688	20,784	24,237	25,643
Total Ancillary & Special Services Revenue	$ 3,448	$ 3,828	$ 3,028	$ 3,671	$ 3,744
Total Operating Revenue	$ **65,711**	**$ 67,052**	**$ 68,090**	**$ 74,932**	**$ 74,779**

Note: In 2011, the PRC approved a new methodology for allocating revenue across products. This new methodology was applied to revenue and volume data relating to 2011 and 2010. These reclassifications did not impact total mail revenue and volume for 2009. The new methodology does not change total revenue.

Operating Statistics

Career Employees	2011	2010	2009	2008	2007
(Actual numbers, unaudited)					
Headquarters and HQ Related Employees					
Headquarters	2,745	2,937	2,811	2,892	2,856
Headquarters - Field Support Units	4,213	4,876	4,455	4,429	4,527
Inspection Service - Field	2,398	2,435	2,617	2,890	2,991
Inspector General	1,123	1,108	1,155	1,159	1,147
Total HQ and HQ Related Employees	10,479	11,356	11,038	11,370	11,521
Field Employees					
Area Offices	809	1,079	1,047	1,316	1,281
Postmasters / Installation Heads	22,212	23,111	23,672	25,250	25,285
Supervisors / Managers	25,083	27,792	28,812	31,787	32,635
Professional Administration and Technical Personnel	4,571	5,926	6,460	8,010	8,058
Clerks/Nurses	149,562	157,168	177,842	194,907	204,305
Mail Handlers	46,596	48,650	52,954	55,812	57,882
City Delivery Carriers	183,774	192,180	200,658	211,661	222,132
Motor Vehicle Operators	7,064	7,413	8,113	8,558	8,726
Rural Delivery Carriers - Full-Time	66,186	66,845	67,749	68,900	67,584
Building and Equipment Maintenance Personnel	36,032	37,403	39,531	40,248	39,948
Vehicle Maintenance Employees	4,883	4,985	5,252	5,419	5,405
Total Field Employees	546,772	572,552	612,090	651,868	673,241
Total Career Employees	557,251	583,908	623,128	663,238	684,762
Noncareer Employees					
Casuals	2,606	6,503	4,271	12,000	22,078
Postal Support Employees	10,471	0	0	0	0
Nonbargaining Temporary	2,259	1,910	1,659	1,119	1,244
Rural Part-Time: Subs / RCA / RCR / AUX	50,349	51,801	54,529	58,072	60,444
Postmaster Relief and Leave Replacements	9,138	11,350	11,477	12,327	12,169
Transitional Employees	13,876	16,215	17,018	18,332	5,232
Total Noncareer Employees	88,699	87,779	88,954	101,850	101,167
Total Employees	645,950	671,687	712,082	765,088	785,929

Note: The Postal Support Employees category was created in 2011.

Operating Statistics

Post Office and Delivery Points	2011	2010	2009	2008	2007
(In actual units indicated, unaudited)					
Post Offices, Stations, and Branches					
Postal-managed					
Post Offices	26,927	27,077	27,161	27,232	27,276
Classified Stations, Branches, and Carrier Annexes	5,219	5,451	5,501	5,509	5,419
Total Postal-Managed	**32,146**	**32,528**	**32,662**	**32,741**	**32,695**
Contract Postal Units	2,904	2,931	3,037	3,148	3,131
Community Post Offices	706	763	797	834	895
Total Offices, Stations, and Branches	**35,756**	**36,222**	**36,496**	**36,723**	**36,721**
Residential Delivery Points					
City Delivery	80,792,112	80,531,231	80,187,505	79,848,415	79,470,894
Rural	39,067,740	38,638,280	38,264,946	37,684,158	37,022,488
PO Box	15,891,349	15,739,698	15,601,883	15,639,031	15,635,480
Highway Contract	2,639,061	2,607,138	2,576,166	2,516,783	2,473,323
Total Residential Delivery	**138,390,262**	**137,516,347**	**136,630,500**	**135,688,387**	**134,602,185**
Business Delivery Points					
City Delivery	7,487,332	7,457,500	7,483,461	7,436,965	7,411,582
Rural	1,468,861	1,453,292	1,439,266	1,407,942	1,360,478
PO Box	4,072,664	4,355,674	4,489,688	4,587,454	4,548,973
Highway Contract	72,872	72,648	72,966	71,538	69,304
Total Business Delivery	**13,101,729**	**13,339,114**	**13,485,381**	**13,503,899**	**13,390,337**
Total Delivery Points	**151,491,991**	**150,855,461**	**150,115,881**	**149,192,286**	**147,992,522**
Change in Delivery Points	636,530	739,580	923,595	1,199,764	1,818,326

Financial History Summary

(Dollars in millions)	2011	2010	2009	2008	2007
Operating Results					
Operating Revenue	$ 65,711	$ 67,052	$ 68,090	$ 74,932	$ 74,778
Operating Expenses					
Compensation and benefits	48,310	48,909	50,883	52,358	53,306
Retiree health benefits*	2,441	7,747	3,390	7,407	10,084
All other operating expenses	19,883	18,770	17,557	17,973	16,715
Total Operating Expenses*	**$ 70,634**	**$ 75,426**	**$ 71,830**	**$ 77,738**	**$ 80,105**
Operating Loss	**$ (4,923)**	**$ (8,374)**	**$ (3,740)**	**$ (2,806)**	**$ (5,327)**
Net Loss	**$ (5,067)**	**$ (8,505)**	**$ (3,794)**	**$ (2,806)**	**$ (5,142)**
P.L.109-435 Payment to PSRHBF*	**$ -**	**$ 5,500**	**$ 1,400**	**$ 5,600**	**$ 8,358**
Workers' compensation expenses	**$ 3,672**	**$ 3,566**	**$ 2,223**	**$ 1,227**	**$ 880**
Financial Position					
Cash and cash equivalents	$ 1,488	$ 1,161	$ 4,089	$ 1,432	$ 899
Property and equipment, net	20,337	21,595	22,680	23,193	23,596
All other assets	1,588	1,570	1,349	1,361	1,352
Total Assets	**$ 23,413**	**$ 24,326**	**$ 28,118**	**$ 25,986**	**$ 25,847**
Total Debt	**$ 13,000**	**$ 12,000**	**$ 10,200**	**$ 7,200**	**$ 4,200**
Net Capital					
Capital contributions of the U.S. government	$ 3,132	$ 3,132	$ 3,087	$ 3,034	$ 3,034
Deficit since 1971 reorganization	(22,072)	(17,005)	(8,500)	(4,706)	(1,900)
Total Net (Deficiency) Capital	**$ (18,940)**	**$ (13,873)**	**$ (5,413)**	**$ (1,672)**	**$ 1,134**

* P.L. 112-33 had the net impact of a $5.5 billion reduction of expenses in 2011. P.L.111-68 had a net impact of a $4.0 billion reduction of expense in 2009. P.L.109-435 had a net impact of a $6.8 billion increase of expenses in 2007 ($8.4 billion in additional Retiree health benefits less $1.6 billion in CSRS savings).

The following are among the many trademarks owned by the United States Postal Service:

United States Postal Service®, U.S. Postal Service®, USPS®, First-Class Mail®, usps.com®, Click-N-Ship®, Automated Postal Center®, APC®, Express Mail®, Priority Mail®, Standard Mail®, Parcel Post®, Media Mail®, Customized MarketMail®, Intelligent Mail®, Parcel Select®, Express Mail International®, Quick, Easy, Convenient®, United States Postal Service Office of Inspector General™, Post Office™, Postal Service™, Signature Confirmation™, Certified Mail™, Delivery Confirmation™, Registered Mail™, ZIP Code™, Carrier Pickup™, Priority Mail International™, First-Class Mail International™, Premium Forwarding Service™, Forever Stamp™ and Postmaster General™.

The Sonic Eagle Logo, Round Top Collection Box design, Letter Carrier Uniform design, and the Mail Truck design are also trademarks belonging to the United States Postal Service.

Glossary

Accounting Standards Codification (ASC). Codifies authoritative accounting literature and guidance into a single source and establishes two levels of U.S. Generally Accepted Accounting Principles, or GAAP — authoritative and nonauthoritative. ASC is the source of authoritative GAAP.

Accruals. Revenue and expenses that are recorded as they occur, even though they may not have actually been paid.

Amortize. To reduce the value of an asset through regular charges to income over time; or to write off expenses by prorating them over a period of time.

Appropriation. Public funds set aside by Congress for a specific purpose.

Asset. An economic resource that is expected to be of benefit in the future.

Cautionary Statements. Statements contained in Management's Discussion and Analysis that represent our best estimate of the trends we know about, the trends we anticipate, and the trends we think are relevant to our future operations.

Capitalize. To treat an expenditure as an asset or to compute the present value of a future payment that will be paid over a period of time.

Contribution. The difference between the revenue from a class of mail and that class's volume-variable costs. For example, if a class of mail has revenue of $1.5 billion and volume-variable costs of $1 billion, its contribution is $500 million, which means that this class of mail covers its costs and contributes $500 million to the common costs of all mail services.

Contingent Liability. A potential liability that is contingent on a future event.

Delivery Confirmation. A special service that provides the date of delivery or attempted delivery for Priority Mail and Standard Mail parcels, Bound Printed Matter, and Library Mail.

Depreciate. To periodically reduce the estimated value of an asset over the course of its useful life.

Direct Mail. A form of advertising often employed by businesses to reach targeted groups of potential customers by mail.

Enhanced Carrier Route. A subclass of Standard Mail for mail pieces weighing less than 16 ounces and prepared in carrier route sequence.

Equity. The difference between the value of all assets less all liabilities.

Express Mail. The Postal Service's premium delivery service, providing guaranteed overnight delivery for documents and packages weighing up to 70 pounds. Both domestic and international services are offered.

First-Class Mail. A class of mail including letters, postcards, and all matter sealed or otherwise closed against inspection. This service is required for personal correspondence, handwritten or typewritten letters, and bills or statements of account.

Fiscal Year. As used in the financial section of this report, the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning October 1 and closing September 30.

Fixed Asset. Any tangible property such as buildings, machinery and equipment, furniture, and leasehold improvements.

Forever Stamp. A stamp that once purchased is good for mailing one-ounce First-Class Mail letters anytime in the future — regardless of price changes. It was introduced in 2007.

Generally Accepted Accounting Principles (GAAP). The rules and procedures of accepted accounting practice as defined by the Financial Accounting Standards Board.

Impaired Asset. When the market value of an economic resource has been permanently lowered below the recorded value of the asset.

Inspector General. The Inspector General is appointed by and reports directly to the Governors of the Postal Service and is independent of postal management. The Office of Inspector General (OIG) primarily investigates and evaluates programs and operations of the Postal Service to ensure the efficiency and integrity of the postal system.

Intelligent Mail. Products and services or a strategy used to describe products and services that use machine readable codes, such as barcodes, to uniquely identify mail. This enables large mailers to follow the progress of their mail through the many stages of processing all the way to delivery.

Glossary

Leasehold. An asset that gives the Postal Service the right to use property under a lease.

Liability. Any debt or obligation that is owed by the Postal Service at some future period of time.

Mailing Services. Market-dominated products as defined by the PRC. These are products for which the Postal Service has market power to set prices substantially above costs without risk of losing business to others. The Mailing Services products include: First-Class Mail letters and sealed parcels; First-Class Mail cards; Periodicals; Standard Mail; single-piece Parcel Post; Media Mail; Bound Printed Matter; Library Mail; Special Services; and single-piece International Mail.

Mailing Flat. A flat is any rectangular or square mail piece that is too big in at least one direction to be a letter. To be a flat, all the following must be true: (a) no side is longer than 15"; (b) the shorter side is 12" or less; (c) the piece is no more than 3/4" thick; and (d) the piece weighs no more than 13 ounces for first class, or is under 16 ounces for standard class.

Operating Expense. Expense that is incurred in providing our primary business services and products.

Operating Margin. A financial indication calculated by dividing income from operations by operating revenue.

Operating Revenue. Revenue that is earned from our primary business services and products.

Office of Personnel Management (OPM). The agency that manages and maintains the government retirement and health benefit plans.

Package Services. Mailing category offered for any merchandise or printed matter weighing up to 70 pounds. These services include Parcel Post, Bound Printed Matter, Library Mail, and Media Mail.

Payable. Money that is owed by the Postal Service.

Periodicals. A class of mail formerly called second-class mail that consists of magazines, newspapers, and other publications.

Postal Inspection Service. The investigative arm of the Postal Service responsible for investigating criminal acts involving the mail and misuse of the postal system.

Postal Regulatory Commission (PRC) (formerly the Postal Rate Commission). An independent federal establishment with oversight responsibility for the Postal Service to review and approve prices, review financial data, and hear and rule on price and service complaints.

Prepaid. Payments made in advance of service being provided.

Present Value. The value today of a future payment that is discounted at a stated rate of compound interest. For example, the present value of $100 that will be paid to the Postal Service 10 years from now is about $38.55, if we discount that $100 at a rate equal to 10% interest compounded annually.

Priority Mail. Priority mail is a 1 to 3-day non-guaranteed delivery service.

Receivable. Money that is owed to the Postal Service.

Recognize. To record in Postal Service accounts as income or expense.

Shipping Services. Products that are not Mailing Services and are considered competitive products. The competitive product list includes Priority Mail, Expedited Mail, Bulk Parcel Post, and Bulk International Mail.

Special Services. A category of services that add value to mail by providing added security, proof of delivery or loss recovery. These services include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation, and insurance up to $1,000.

Standard Mail. Mailing service offered for any item, including advertisements and merchandise weighing less than 16 ounces that are not required to be sent using First-Class Mail. Standard Mail is typically used for bulk advertising to multiple delivery addresses.

U.S. Mail. Any mailable matter that is accepted for mail processing and delivery by the Postal Service.

Universal Service. The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere.

Workshare. Tasks performed by mailers that otherwise would be done by the Postal Service, such as preparing, sorting, barcoding, and transporting mail. Reduced postage rates are offered to these customers.

Signatures

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, the United States Postal Service has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

United States Postal Service

/s/ Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Date: November 15, 2011

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, this Report has been signed below by the following persons on behalf of the Postal Service and in the capacities indicated as of November 15, 2011.

Signature	Title
/s/ Louis J. Giuliano Louis J. Giuliano	Chairman of the Board of Governors
/s/ Thurgood Marshall, Jr. Thurgood Marshall, Jr.	Vice Chairman of the Board of Governors
/s/ Mickey D. Barnett Mickey D. Barnett	Governor
/s/ James H. Bilbray James H. Bilbray	Governor
/s/ James C. Miller III James C. Miller III	Governor
/s/ Dennis J. Toner Dennis J. Toner	Governor
/s/ Ellen C. Williams Ellen C. Williams	Governor

Signature	Title
/s/ Patrick R. Donahoe Patrick R. Donahoe	Board Member, Postmaster General and Chief Executive Officer
/s/ Ronald A. Stroman Ronald A. Stroman	Board Member and Deputy Postmaster General
/s/ Joseph Corbett Joseph Corbett	Chief Financial Officer and Executive Vice President (Principal Financial Officer)
/s/ Timothy O'Reilly Timothy O'Reilly	Vice President, Controller (Principal Accounting Officer)

Exhibit 10.4

AMENDMENT TO, AND CLARIFICATION OF, EMPLOYMENT AGREEMENT

The Employment Agreement between the United States Postal Service and Paul E. Vogel, previously signed July 27, 2010 ("Agreement"), is clarified and amended as set forth below. This amendment and clarification shall be effective as of September 30, 2011, meaning that it shall govern Mr. Vogel's eligibility for a performance incentive for each of the twelve-month performance periods set out in sub-paragraphs i. through iv. below.

1. Paragraph 6.b of the Agreement is stricken and replaced with the following:

   In addition to all other compensation specified in this agreement, Mr. Vogel shall be eligible to receive a performance incentive, as set forth in this paragraph. For each twelve-month period listed below in this paragraph, Mr. Vogel shall be entitled to, at a minimum, a performance incentive award of 25% of his basic salary in effect as of the end of each twelve-month period, provided the Postmaster General determines Mr. Vogel discharged his duties in a satisfactory manner during the relevant twelve-month period. The maximum amounts he may be awarded for each twelve-month period are specified below in this paragraph. Within the limits established by this paragraph for the annual minimum and maximum amounts, the Postmaster General, in his sole discretion, shall determine the amount of the performance incentive to be awarded for each twelve-month period. The Postmaster General shall make this determination no later than December 31 of each year specified below, and all amounts due to Mr. Vogel will be paid, or accrued pursuant to paragraph 7 of this Agreement if required by law, no later than sixty days after the Postmaster General determines the amount to be awarded to Mr. Vogel pursuant to this paragraph. Mr. Vogel's right to a performance incentive award for each twelve-month period specified below shall vest, and not be subject to forfeiture, as of September 30 of each twelve-month period specified below, as long as he remains employed by the Postal Service as of that date. In the event Mr. Vogel separates from the Postal Service for a reason other than cause prior to the conclusion of any twelve-month period listed below, then for that period, he shall be entitled to receive a prorated fractional performance incentive, calculated as follows: First, a fraction shall be created by dividing by twelve the number of full calendar months during the relevant twelve-month period that Mr. Vogel was employed by the Postal Service. Second, the basic salary in effect as of the date of Mr. Vogel's separation from the Postal Service shall be multiplied by the fraction derived pursuant to the foregoing sentence. Third, the amount derived pursuant to the foregoing sentence shall be multiplied by a percentage, as determined by the Postmaster General. This percentage shall be within the range established for the pertinent time period, per subparagraphs i through iv, below.

i. For the twelve-month period ending on September 30, 2011, the amount of the performance incentive shall be up to 50% of Mr. Vogel's basic salary as of September 30, 2011.
ii. For the twelve-month period ending on September 30, 2012, the amount of the performance incentive shall be up to 50% of Mr. Vogel's basic salary as of September 30, 2012.
iii. For the twelve-month period ending on September 30, 2013, the amount of the performance incentive shall be up to 50% of Mr. Vogel's basic salary as of September 30, 2013.
iv. For each twelve-month period ending on September 30 of each year following 2013 during which he is employed as an officer of the Postal Service, the amount of the performance incentive shall be up to 50% of Mr. Vogel's basic salary as of September 30, subject to proration as set forth in paragraph 5.b of this agreement.

Postal Service

Date: 11/14/11

Paul E. Vogel

Date: 11/10/11

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Exhibit 10.6

AMENDMENT TO AGREEMENT FOR RETENTION INCENTIVE

The Agreement For Retention Incentive between the United States Postal Service and Anthony J. Vegliante, signed November 10, 2010 ("Agreement"), is amended as follows, effective as of November 1, 2011.

1. Paragraphs 2.b and 2.c of the Agreement are amended by striking sub-paragraphs 2.b and 2.c of the Agreement in their entirety and by inserting the following as sub-paragraphs 2.b and 2.c, respectively:

> Mr. Vegliante shall be eligible to receive a performance-based retention incentive, as set forth in this paragraph, and in revised paragraph 3 of the Agreement, as set forth below. In the event the Postmaster General determines that Mr. Vegliante performed his duties in a satisfactory manner during the twelve-month period beginning November 1, 2011, Mr. Vegliante shall be entitled to an award of a retention incentive in an amount equal to 25% of Mr. Vegliante's basic salary in effect as of October 31, 2012, as long as he remains employed by the Postal Service as of October 31, 2012. In the event Mr. Vegliante terminates his employment from the Postal Service for a reason other than cause prior to October 31, 2012, he shall be eligible to receive a prorated performance-based retention award, as further specified in revised paragraph 3 of the agreement, as appears below. The Postmaster General shall determine no later than December 31, 2012 whether Mr. Vegliante performed his duties in a satisfactory manner during the twelve-month period ending on October 31, 2012.
>
> Both parties may mutually agree to extend this agreement on an annual basis for each twelve-month period commencing on November 1 of each year after November 1, 2011, so that the amount of the retention incentive shall be 25% of Mr. Vegliante's basic salary in effect as of the end of the relevant twelve-month performance period, subject to proration for the relevant performance period, as specified in revised paragraph 3, below. Any such extension shall be in writing, and signed by both parties.

2. With regard to the payment authorized in revised sub-paragraph 2.b, above, paragraph 3 of the Agreement is stricken and replaced with the following as paragraph 3 in its place:

> In the event Mr. Vegliante separates from the Postal Service for a reason other than cause prior to October 31, 2012, he shall be eligible to receive a prorated fractional performance incentive, subject to the Postmaster General's assessment of his performance and determination that a performance-based retention award is merited, in an amount derived as follows: First, a fraction shall be created by dividing by twelve the number of full calendar months during the period of November 1, 2011 through October 31, 2012 that Mr.Vegliante

was employed by the Postal Service. Second, the amount that would be due Mr. Vegliante under revised sub-paragraph 2.b of the Agreement, above, if he had remained employed by the Postal Service throughout the twelve-month period commencing on November 1, 2011, shall be multiplied by the fraction derived pursuant to the foregoing sentence.

3. Paragraph 4 of the agreement shall be inapplicable to any retention incentive awarded to Mr. Vegliante pursuant to revised sub-paragraph 2.b or revised paragraph 3 of the Agreement. The payment of all amounts awarded to Mr. Vegliante pursuant to revised sub-paragraph 2.b or revised paragraph 3 of the Agreement shall be deferred in their entirety and shall be treated as provided in the Postal Service's standard policy on deferred compensation.

4. To the extent it may be determined there is any inconsistency between this Amendment and the Agreement For Retention Incentive between the United States Postal Service and Anthony J. Vegliante, signed November 10, 2010, this Amendment shall control.

Postal Service

Date: 11/14/11

Anthony J. Vegliante

Date: 11/14/11

Exhibit 31.1

CERTIFICATION PURSUANT TO RULES 13A-14(A) AND 15D-14(A) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Patrick R. Donahoe, certify that:

1. I have reviewed this annual report on Form 10-K of the United States Postal Service (Postal Service);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;

4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) for the Postal Service and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and

5. The Postal Service's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Postal Service's internal control over financial reporting.

Date: November 15, 2011

/s/ Patrick R. Donahoe____________________
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO RULES 13A-14(A) AND 15D-14(A) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph Corbett, certify that:

1. I have reviewed this annual report on Form 10-K of the United States Postal Service (Postal Service);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;

4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) for the Postal Service and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and

5. The Postal Service's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Postal Service's internal control over financial reporting.

Date: November 15, 2011

/s/ Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President

Exhibit 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of the United States Postal Service (Postal Service) on Form 10-K for the period ended September 30, 2011, (the Report), I, Patrick R. Donahoe, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: November 15, 2011

/s/ Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of the United States Postal Service (Postal Service) on Form 10-K for the period ended September 30, 2011 (the “Report”), I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: November 15, 2011

/s/ Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President